

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,

Plaintiff,

-against-

ROBERT PFAFF,

Defendant.

CASE NO. 08 CR 239 RMB

**DECLARATION OF DAVID C. SCHEPER
IN SUPPORT OF DEFENDANT ROBERT
PFAFF'S MOTIONS FOR A CHANGE OF
VENUE AND FOR A BILL OF
PARTICULARS**

**Hearing Date: September 23, 2008
Time: 10:00 a.m.**

I, David C. Scheper, declare as follows:

1. I am an attorney, licensed to practice law with the courts of the State of California. I am an attorney at Overland Borenstein Scheper & Kim LLP, counsel of record for defendant Robert Pfaff. I have personal knowledge of the facts stated herein, unless otherwise indicated, and could and would testify to such facts.

2. Attached hereto as Exhibit A is a true and correct copy of the transcript of the oral argument in the case United States v. Stein et al., 05 Cr. 888 (LAK) which occurred on May 8, 2007.

3. Attached hereto as Exhibit B is a true and correct copy of the Affidavit of Service of a civil subpoena served on Domenick DeGiorgio in Cold Spring Harbor, New York.

4. Attached hereto as Exhibit C are true and correct copies of excerpts of the transcripts of an interview of Mr. Pfaff by the IRS which took place in Denver, Colorado on June 12-13, 2003.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed in Los Angeles, California, this 18th day of August 2008.

/S/
David C. Scheper

EXHIBIT A

Part 1

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1 UNITED STATES DISTRICT COURT
1 SOUTHERN DISTRICT OF NEW YORK
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3 UNITED STATES OF AMERICA,
3
4 v. 05 Cr. 888 (LAK)
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5 JEFFREY STEIN, JOHN LANNING,
5 RICHARD SMITH, JEFFREY
6 EISCHEID, PHILIP WIESNER, JOHN
6 LARSON, ROBERT PFAFF, RAYMOND
7 RUBLE, MARK WATSON, DAVID AMIR
7 MAKOV, LARRY DELAP, STEVEN
8 GREMMINGER, GREGG RITCHIE,
8 RANDY BICKHAM, CAROL WARLEY,
9 CARL HASTING, RICHARD
9 ROSENTHAL, DAVID GREENBERG,
10
10 Defendants.
11 -----x
12

12 May 8, 2007
13 2:45 p.m.
13

14 Before:
14

15 HON. LEWIS A. KAPLAN,
15 District Judge
16
17

17 APPEARANCES
18

18 MICHAEL J. GARCIA
19 United States Attorney for the
19 Southern District of New York
20 BY: STANLEY OKULA
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21 RITA GLAVIN
21 Assistant United States Attorneys
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24 CRAIG MARGOLIS
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6 BY: CAROLINE RULE
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16 Attorneys for Defendant Greenberg
17 BY: DAVID B. PITOFSKY

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2 (Case called)
3 THE COURT: The first thing I wanted to take up before
4 we get to the motion is the government's database proposal,
5 which I take it you've all agreed on now. Right?
6 MR. HILLEBRECHT: I believe that's correct, your
7 Honor.
8 THE COURT: So I know there was some reference from
9 the government at some point to wanting my approval. But my
10 approval is not necessary for this, is it?
11 MR. HILLEBRECHT: As long as the Court has no
12 objection.
13 THE COURT: I'm certainly not objecting to it.
14 MR. HILLEBRECHT: And, your Honor, did you receive our
15 letter of this afternoon?
16 THE COURT: I did. And I noticed the 16 weeks, and
17 we'll see what happens to the trial date. But I'm not making
18 promises.
19 Okay. The way I would like to organize the discussion
20 of the government's 404(b) motion is to do it topically, rather
21 than to simply listen to a bunch of set speeches. And the way
22 we'll do it is I'll indicate the topic and then I'll hear from
23 the government and I'll hear from the defense, subject by
24 subject. So let's begin with the UMDA, Sands, Scandia and
25 some evidence, which I take, I hope correctly, to rid more or
less the same sorts of issues on both sides.

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2 Mr. Okula.
3 MR. OKULA: Thank you, your Honor. Good afternoon.
4 Just at the outset, your Honor, I'd like to point out,
5 sort of reevaluate how best we can present and in a streamlined
6 fashioned, if approved by the court, we are attempting to pick
7 our spots, I think, in a little more refined manner. So we're
8 going to set aside and essentially withdraw the Scandia-related
9 matter. So we're going to stick to the Somer Leasing and Sands
transaction as the first topic.
10 THE COURT: Does that totally moot any questions
11 regarding Norwegian depositions?
12 MR. OKULA: No.

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13 THE COURT: It doesn't, okay. Go ahead.
14 MR. OKULA: Your Honor, this case involves in
15 substantial part the existence of bona fide loans underlying
16 the tax shelter transaction, starting first with the Somer
17 Leasing transaction. The Somer Leasing transaction involves an
18 endeavor by Mr. Pfaff to enlist a nonresident alien, a person
19 who had no legitimate entrepreneurial reason to be in the
20 transaction other than to act as a straw person, a foreign
21 person, to absorb the tax at the end of the transaction.

22 We will be able to prove through the testimony of that
23 straw person that he was enlisted by Mr. Pfaff. In fact, he
24 was sent a letter by Mr. Pfaff essentially telling him you are
25 the owner of this company. This company will take out a loan

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2 from HVB. Here are the terms of the loan, here is where the
3 funding is coming from, and, by the way, you'll get \$25,000 at
4 the end of the transaction.

5 There will also be testimony from Mr. DeGiorgio, who
6 is going to be a government witness, a cooperating witness, who
7 was involved with Mr. Pfaff in structuring this Somer Leasing
8 transaction, and he will testify that the person who was
9 enlisted to be the NRA, the Philippines person, Mr. Romero
10 Salas, was not a bona fide participant in the transaction and
11 that the tax play, at the heart of the transaction, ended up
12 with that person having the gain, but because he was a foreign
13 person, no tax was paid at the end of the transaction.

14 So, I think, your Honor, the clear relevance of the
15 admissibility of this proof is that it involves a loan that is
16 not bona fide, that was not taken out legitimately by this NRA.
17 The NRA was inserted into the transaction. He's not a
18 legitimate participant in the transaction, and the transaction
19 is a fraud. It involved Mr. Pfaff enlisting that person and
20 dealing with that person and getting fees at the end of the day
21 from that transaction.

22 THE COURT: Take it in smaller steps. What makes that
23 a fraud?

24 MR. OKULA: Because if you enlist a foreign person who
25 is simply a puppet, who is not a genuine participant in the
transaction, who has no true entrepreneurial reason for being

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2 in the transaction, and who is falsely depicted in some of the
3 deal documents as being entrepreneurial, a participant in the
4 transaction, that is, that he is in it for investment purposes,
5 that he thinks that these leases that the basis gets
6 transferred with were a good investment, that's in your
7 write-up at the bank, and it's false.

8 THE COURT: It's in what write-up at the bank?

9 MR. OKULA: The credit memo at the bank, in order to
10 get the loan approved from HVB to this straw person, depicts
11 this straw person --

12 THE COURT: Was the loan made to the straw person, or
13 was it made to the entity?

14 MR. OKULA: It was made to the entity. But it's a
15 single-member LLC, so it has to describe who the person behind
16 the entity is. And it describes him as a legitimate
17 businessman involved in entrepreneurial efforts. He thinks
18 these leases are a good investment.

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18 THE COURT: Was the person not a legitimate business
19 person? I mean, I understand you call it a straw.
20 MR. OKULA: Not for the purpose that they depicted him
21 in the write-up, your Honor.
22 THE COURT: That wasn't exactly my question.
23 MR. OKULA: He was a business person, yes.
24 THE COURT: Okay.
25 MR. OKULA: But he had no knowledge of the ins and
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2 outs of the transaction. He had no say in the ins and outs of
3 the transaction. He was simply sent paperwork, which he signed
4 without review, after it was forwarded to him where people
5 simply said sign this and you will get a fee at the end of the
day.

6 THE COURT: I'm going to portray a lot of ignorance of
7 tax law here this afternoon, I'm very well aware of that. I
8 deliberately decided not to practice tax law, and I'm now
9 convinced that was probably a good idea. But don't nominees
10 participate in transactions purely as nominees all the time,
11 throughout the economy, including transactions that are
12 relevant to getting one sort of tax treatment versus another
13 kind of tax treatment?

14 MR. OKULA: I think as a general principle, in a
15 vacuum, the answer to that is yes, your Honor. But I think in
16 our case here, it's the equivalent of looking at a phone book
17 of a foreign country, dialing up that person's number and
18 saying, I want you to end up with this gain at the end of the
19 day and we'll pay you a little fee, will you participate.

20 THE COURT: You're talking to a first year law
21 student, for all practical purposes, on the issue of the tax
22 law. Take me through it one step at a time, exactly what
23 happened and which steps violate which provisions of the
24 Internal Revenue Code.
25

MR. OKULA: The way that it was set up.
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2 THE COURT: Because I confess, I read your brief, and
3 it was a very erudite discussion of all sorts of Rule 404(b)
4 cases and a lot of adjectives, and at the end of it I didn't
5 know exactly what the transactions were or why you claim they
were bad.

6 MR. OKULA: The Somer Leasing transaction went in the
7 following manner. A loan was established at HVB. Mr. Pfaff
8 met with the taxpayer, a California businessman, who needed a
9 tax loss. Mr. Pfaff sat down with Mr. Degiorgio and discussed
10 ideas about how they were going to create a tax loss for this
11 California businessman. They decided they were going to use
12 this transaction, which is called a 357(c) transaction, which
13 is a section of the Internal Revenue Code that was used as the
14 play here.

15 THE COURT: What does 357(c) say?
16 MR. OKULA: 357(c) essentially establishes that when
17 there is a, well, if I continue my conversation, your Honor,
18 I'll describe how it came into play.

19 THE COURT: Okay.
20 MR. OKULA: Mr. Pfaff designed this deal. What they
21 needed was a nominee, a person who can absorb the tax loss at
22 the end of the day, because what they were going to do was

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23 transfer the basis and leave the gain with one person while
24 creating a loss that could be used by the California
25 businessman. They did it in the following manner. They had an
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1 entity created in New York. Mr. Pfaff took care of creating
2 the entity in New York, unbeknownst to the Philippine national.
3 The single-member LLC was created, and Mr. Pfaff arranged for a
4 half million dollars of financing to be sent to this entity.

5 THE COURT: This is the loan?
6 MR. OKULA: No, not the loan. It's just an initial
7 fee that had to be paid for HVB to get the transaction started.
8 THE COURT: Where did the half million dollars come
9 from?

10 MR. OKULA: It came from an account in Gaum that was
11 controlled by a coconspirator named Stuart Moisen who Mr. Pfaff
12 enlisted to send the money to Somer Leasing.

13 THE COURT: So Moisen sends a half million dollars to
14 HVB as a loan application fee?

15 MR. OKULA: As part of the initial funding of the
16 transaction, yes, your Honor. It's part of the loan
17 application, yes.

18 THE COURT: so it's a fee to HVB.

19 MR. OKULA: Yes.

20 THE COURT: All right.

21 MR. OKULA: The deal is structured as a purported
22 30-year loan by HVB in the amount of \$25 million that is made
23 to this entity, Somer Leasing LLC. After the loan is put into
24 place, and Somer Leasing --

25 THE COURT: Is this a nonrecourse loan or something?

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1 MR. OKULA: It is. There's recourse.
2 THE COURT: Against Somer Leasing?
3 MR. OKULA: Correct.
4 THE COURT: Okay.
5 MR. OKULA: The money is then, let me just back up a
6 second. The 30-year loan, Pfaff tells the Philippine national,
7 he basically informs him you're the owner now of Somer Leasing
8 LLC. \$500,000 has been sent to HVB as an initial funding of
9 the transaction. And he describes certain steps or certain
10 paperwork that would have to be signed after it was forwarded
11 to him by the New York lawyer. The deal is structured in the
12 following manner.

13 A \$25 million loan is given to Somer Leasing, and
14 Somer Leasing is then going to use 1 million of that to
15 purchase certain leases. They're equipment leases that
16 Mr. Pfaff had arranged to be purchased from an equipment
17 leasing company called Somerset Capital. The bank documents
18 required essentially full collateralization of the loan, so
19 only 1 million of the 25 million was used to purchase the
20 leases. 24 million stayed at HVB, and the leases that were
21 purchased by Somer Leasing were used to secure the rest of the
22 loan, to keep HVB collateralized.

23 At that point, the U.S. taxpayer who wants the tax
24 loss --

25 THE COURT: Before we get there, what happens to the
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2 24 million at this point?
3 MR. OKULA: It had to be kept at an account at HVB in
4 New York.

5 THE COURT: So the leases are not securing the 25
6 million, they're securing the 1 million?

7 MR. OKULA: The \$1 million, correct.

8 THE COURT: Now what?

9 MR. OKULA: United States taxpayer who wants the loss
10 then purchases the lease portfolio from Somer Leasing LLC. He
11 pays \$1.6 million to Somer Leasing; 1 million of that goes back
12 to HVB to keep it fully collateralized now, and 600,000 stays
13 in Somer Leasing and it's distributed among the coconspirators
14 as their various fees.

15 The tax play here is that the U.S. taxpayer becomes a
16 co-obligor on the loan.

17 THE COURT: Which happens how?

18 MR. OKULA: What happens is when they, as part of the
19 deal, when they purchase the leases from Somer Leasing LLC,
20 they sign on with HVB as a co-obligor on the loan. Now,
21 because Somer Leasing is transferring property, that is the
22 lease portfolio, and also getting some shares of the entities
23 set up by the United States taxpayer to take part in this
24 transaction, the U.S. company, the taxpayer, through his
25 entity, gets the same basis --

THE COURT: Back up. Where and when does the U.S.

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2 taxpayer set up an entity, and how does it participate in the
3 transaction?

4 MR. OKULA: They set up the entity at the outset of
5 the transaction, and they wait for these initial steps to take
6 place until they are told that they have to pay the
7 consideration to Somer Leasing in order to get the leases.

8 THE COURT: So, is it correct that it's the taxpayer's
9 entity, not the taxpayer --

10 MR. OKULA: That's correct.

11 THE COURT: -- that buys the leases and becomes
12 co-obligor?

13 MR. OKULA: That's correct. And it gives preferred
14 shares in its new company to Somer Leasing, in addition to the
15 \$1.6 million.

16 Now, one thing I didn't point out earlier, your Honor,
17 although they paid at the outset \$1 million for the lease, the
18 leased equipment --

19 THE COURT: Somer Leasing paid?

20 MR. OKULA: That's right.

21 There was a \$6 million basis in that property, because
22 there was \$5.8 million of debt connected with those leases,
23 that the leasing company sold.

24 THE COURT: Wait a second. The leasing company is
25 selling leases?

MR. OKULA: Correct. That are encumbered by debt.

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2 THE COURT: By how much?
3 MR. OKULA: \$5.8 million.
4 THE COURT: So Somer is paying a million dollars plus

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4 the assumption of the liability?
5 MR. OKULA: That's correct.
6 THE COURT: So Somer's basis in the leases is now 6.8
7 million?

8 MR. OKULA: Correct.
9 THE COURT: All right.
10 MR. OKULA: Now, when the U.S. company pays the
11 consideration for the leases, it gets the basis that Somer had
12 in the leases. And that's under Section 351 of the Internal
13 Revenue Code. And this is where Section 357(c) comes in,
14 because Section 357(c) provides that when a company assumes
15 indebtedness or when the U.S. company assumes the indebtedness
16 of Somer, Somer has to recognize a gain equal to the amount by
17 which the debt, that is the \$25 million, exceeds the basis in
18 the leases. So it's about a 17 or \$18 million difference.

19 The write-up at HVB in connection with this basically
20 says that the Philippine national, who is Somer, is then going
21 to have to recognize the \$18 million gain at this point in the
22 transaction, but because the person is a foreign person, not
23 subject to U.S. tax, there's no taxpayer in the transaction.

24 Now, what happens is the U.S. company gets to take the
25 full amount of the indebtedness as its basis in the lease; that

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1 is, the \$25 million. So even though there's a debt attached of
2 about \$5.8 million to the leases, it gets \$25 million in basis
3 in the lease, which they then depreciate, they get to use for
4 corporate purposes as losses in their entity.

5 THE COURT: I'm sorry. I thought you told me a few
6 minutes ago that the U.S. entity gets Somer's \$6.8 million
7 basis and the leases under 351.

8 MR. OKULA: They do, but when 357(c) kicks in and the
9 gain has to be recognized by the transferor of the property,
10 357(c) also provides then that the transferee has to have a
11 basis in the amount of the obligation, which is the \$25
12 million.

13 So implicit in all this is the notion that you have a
14 legitimate business person in the Philippines, a foreign
15 person, taking part in this transaction, and the proof that we
16 are prepared to introduce is this person had no interest in the
17 transaction. They were simply enlisted to lend their name to
18 the transaction in exchange for a \$25,000 fee. They made no
19 decisions. All the decisions were made for it. And all of the
20 steps were prearranged and orchestrated in advance. So there's
21 this \$18 million loss that is never recognized, and we submit
22 that that is a fraud, a fraud because the person is not a
23 legitimate participant in the transaction, and implicit in sort
24 of a good deal going forward is the presence of someone who is
25 a legitimate participant in the transaction.

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1 THE COURT: I seem to have this recollection that
2 Justice Holmes or Learned Hand or one of those memorable
3 figures once said something like this, that everybody has a
4 duty to pay the taxes that are justly owed and that everybody
5 also has the right to so arrange his or her affairs as to
6 minimize the tax that is due and owing. Fair statement?

7 MR. OKULA: Very fair, your Honor.
8 THE COURT: Okay. So?

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9 MR. OKULA: It's not applicable in this situation
10 because you cannot insert somebody who is not a bona fide
11 participant in the transaction.

12 THE COURT: What provision of the code says that?

13 MR. OKULA: I don't have the case law in front of me
14 here, your Honor. I don't think there's a section in the code,
15 but I think that you cannot have just a nominee or a straw
16 person. I'd be happy to, in the wake of the hearing, find the
17 cases and submit that to you, your Honor. But this is a person
18 who made no decisions, offered no money for the transaction,
19 and was depicted in the paperwork as being an entrepreneur.

20 THE COURT: Let's get to that. Depicted in exactly
21 what paperwork and by whom?

22 MR. OKULA: Depicted in the paperwork at HVB in order
23 to give rise to the loan and depicted in the opinion letter
24 given by the law firm to HVB for their issuance or their
25 participation in the transaction.

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1 THE COURT: What law firm?

2 MR. OKULA: Shearman & Sterling.

3 THE COURT: Now, the paperwork at HVB, who wrote it?

4 MR. OKULA: DeGiorgio. He wrote the credit memo up.

5 THE COURT: And what's he going to say about why he
6 wrote it the way he wrote it?

7 MR. OKULA: He's going to say that he wrote it up
8 because he sat down with Mr. Pfaff and structured this
9 transaction in order to create simply a tax loss for the
10 California businessman who owned the United States company, and
11 he will testify that the person in the Philippines was a straw
12 person who had no legitimate participation in the transaction,
13 wasn't contacted, wasn't spoken to. They didn't expect him to
14 provide legitimate funding himself, and he knew the person was
15 a bogus participant in the transaction.

16 Notwithstanding that, in the credit memo, the credit
17 request, dated March 1998, when writing it up, DeGiorgio
18 describes Somer Leasing by saying it's "in the business of
19 making equity investments in newly created businesses,
20 acquiring income-producing assets and making other financial
21 investments. For each transaction or investment in which the
22 owner of Somer participates, he establishes a new entity with
23 no other creditors, business transactions or obligations." And
24 he goes on to describe a little bit more about the owner and
25 his legitimate entrepreneurial intent to bring into the

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1 transaction. It's all false. It's all false.

2 Mr. Romero Salas, who is the Philippine national, will
3 testify that he was not spoken to before any of this was set
4 up, that he made no decisions about this, he didn't hold any
5 leases, he didn't know about any leases, he didn't know about
6 any investment. And all he did was, he was promised \$25,000,
7 and he took \$25,000 at the end of the day. And this is a
8 person, by the way, with respect to some of the other proof
9 that we are seeking to admit, whose bank account was employed
10 in order to filter off-shore some of the fees that the
11 participants received and did not report to the IRS.

12 THE COURT: Now, in order for you, assuming that your
13 theory holds together, to have this make sense to anybody, and

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14 by anybody, of course, I mean the jury, don't you have to
15 explain the whole transaction and the relevant tax law to the
16 jury?

17 MR. OKULA: I don't think so, for the following
18 reason, your Honor. I think that to have the jury instructed
19 if the law is as we believe it is, that you have to be a bona
20 fide, legitimate participant in the transaction in order for
21 the tax play to work, that simply an instruction by the Court
22 with respect to that topic and the testimony of the person that
23 they were simply a straw person, together with, for instance,
24 the credit memo describing the transaction and the testimony of
25 DeGiorgio, is all we're going to have to introduce. So I don't

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1 think there has to be a lengthy exegesis on 351 and 357(c). It
2 simply has to be that because the tax play involved dropping
3 with a foreign person this tax and you have to be a legitimate
4 participant in the transaction in order for the tax play to
5 work, simply an economic substance type of charge, which I
6 believe underlies this type of transaction and this type of
7 fraud, would be enough.

8 THE COURT: What about the other one, the UMDA Sands?

9 MR. OKULA: Sands also involved a fraudulent loan for
10 what was depicted as a loan, but none of the participants
11 expected the loan to be, and let me just take it from step one,
12 your Honor.

13 THE COURT: When you say fraudulent loan, what do you
14 mean, that someone lied in order to procure the loan?

15 MR. OKULA: No. I got ahead of myself. I'll walk
16 your Honor through it.

17 A promoter of the Sands tax shelter, a man named Roy
18 Hahn, he worked with Raymond Ruble in putting together Sands,
19 and Sands was depicted as an ability to create low-cost
20 financing for the entity participating in the transaction.

21 what happened in Sands is that an individual that
22 Mr. Pfaff was familiar with a man named Michael Grandinetti,
23 who is a key official at a company called the United Micronesia
24 Development Association, which is a Saipan-based company.
25 Moisen and Pfaff learned that UMDA was about to receive a big

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1 dividend in an amount of about \$13 million, and they had to
2 address the tax consequences of that. Pfaff and Moisen
3 approached Grandinetti with Roy Hahn and said, Here is this
4 transaction, it's called Sands. And what it will let you do is
5 essentially you pay a fee to us and we set up the transaction
6 and we will make available to you this low-cost financing from
7 Deutschebank, and it's all basically smoke and mirrors. There
8 is no legitimate loan that is made available to them.

9 Going into the transactions, Grandinetti, all he
10 wanted was to get rid of the taxes and had no true intent in
11 taking out the loan. And he will testify to that, that he was
12 approached by Hahn and Pfaff and they pitched this deal, which
13 supposedly involved our ability as a company, UMDA, to take out
14 a big loan, but I had no intent to take out a loan, we didn't
15 need a loan, we needed a tax loss, and through the tax play at
16 issue there, it essentially made the dividend go away. It
17 created a big loss through a transfer basis.

18 Grandinetti got what he wanted and paid the fees to

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19 Pfaff and Moisen and Hahn, and then they approached him and
20 said, well, in order for this to work, in order for it to be
21 consistent with the code, you have to say that you have a
22 business purpose for engaging in this transaction, that you
23 really want the loan to use for financing for your company.

24 THE COURT: This is another case where the gain winds
25 up with another nonresident alien, right?

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1 MR. OKULA: No, your Honor.

2 THE COURT: Okay. Go ahead.

3 MR. OKULA: And the essential fraud at issue in Sands
4 is there was no legitimate business purpose for UMDA to take
5 out the loan. Notwithstanding that, Grandinetti signed
6 paperwork and engaged in discussions where he agreed falsely to
7 represent, to the promoters of the transaction, that there was
8 a legitimate business purpose behind the loan; that is, to use
9 it for financing of UMDA's activities. And after they got
10 their tax loss through the tax play there, there was no drawing
11 down of the funds at all. The loan was never issued. It was
12 never used, and in all the Sands transactions we're not
13 charging any other ones, but there's no coincidence that in
14 five or six other transactions that Mr. Ruble was involved in
15 which depict the financing or the ability to get financing,
16 nobody takes out the loan. But everybody is forced to say as a
17 condition of getting in the door, in order to make the tax play
18 work, that they are engaging in the transaction because they
19 want the ability to use the low-cost financing.

20 Now in these two instances that we have been talking
21 about up to now, we have got Pfaff implicated in the first one
22 Ruble implicated in the second.

23 (Continued on next page)

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1 THE COURT: Anybody else among the defendants in this
2 case?

3 MR. OKULA: No, your Honor.

4 THE COURT: What is your answer to the argument that
5 even if you are right as to Pfaff in the one case and Ruble in
6 the other, the potential spillover here, not just in the normal
7 sense of prejudicial spillover but in the sense of consumption
8 of time and everything else, is unfairly prejudicial to
9 everything else?

10 MR. OKULA: I think, short answer to that, your Honor,
11 is it presents in any multiple defendant case, the fact that
12 some defendants engage in more criminal conduct or significant
13 amount of additional other activity, I think could be dealt
14 with -- and the courts recognize up and down -- could be dealt
15 with with a limiting instruction. And with respect to the
16 usage of time, your Honor --

17 THE COURT: You got a case with a six or eight month
18 trial and 18 defendants where that was upheld?

19 MR. OKULA: I have not looked into it up to this date,
20 your Honor, but I would be happy to look into it and get your
21 Honor authority with respect to that, with respect to that
22 point, to the extent it exists. And I believe it does.

23 THE COURT: Okay. Let me hear from defense on these

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24 two transactions.

25 MR. OKULA: Just before, may I add one more point with
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1 respect to the Sands transaction. The Sands transaction is
2 tied in in an important way with another part of 404(b) proof.
3 That is the receipt or payment to Ruble of unreported fees that
4 is at the same time, in 1996, when he is writing the opinion
5 letter, he is receiving payments from the promoter of the
6 transaction.

7 THE COURT: I understand that. Thank you.

8

9 MR. SCHEPER: David Scheper for Mr. Pfaff.

10 When I think we all first assembled back sometime in
11 the fall of 2005, one of the first things I heard from your
12 Honor was the phrase, "boil it down." And we are 20 or so
13 months later, having your Honor preside over a hearing where
14 the government's reaction was to boil it up. With respect to
15 the --

16 THE COURT: Frankly, you know, I have read these
17 fairly lengthy papers. And I have read a lot of case law about
18 404(b) that I pretty much knew and heard a lot of rhetoric and
19 read a lot of rhetoric. And what I'm really interested in,
20 today, is the facts and what any of this evidence really
21 suggests. The rest of it I can do in my sleep.

22 THE WITNESS: Well, I think the fact, one of the facts
23 is that, as your Honor has sort of alluded to with respect to
24 summer leasing, showing that this was a criminal transaction
25 involves a lot more than just somebody coming in and saying, I

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1 served improperly as a nominee.

2 I think what that requires, your Honor, in a trial,
3 whether it is United States v. Robert Pfaff, or United States
4 v. Stein, et al, to show that this was a criminal conduct and
5 bad acts would require the law firms that have been identified.
6 Sherman & Sterling is one law firms. There was a US taxpayer
7 who we're told had a meeting with Mr. Pfaff where his reasons
8 for entering into a transaction were identified. Well, he is
9 not in the 404(b) notice, and he is not a witness. But that
10 taxpayer, and I'll represent to your Honor, had advisors,
11 accountants, lawyers, who guided that US taxpayer through the
12 thicket of the summer leasing transaction. And then, your
13 Honor, there -- there was the transaction, heavily lawyered, by
14 a lot of sides.

15 THE COURT: Do you agree with Mr. Okula that if a
16 foreign nominee who basically had nothing to do with this
17 transaction other than to collect a fee was plugged into this
18 and to wind up being the person to whom the gain for income was
19 taxable, that that is improper.

20 MR. SCHEPER: If that person, your Honor, was a liar
21 and a fraudster and perpetrated a fraud on US taxing
22 authorities or, in turn, on Philippine taxing authorities, that
23 person would have a problem. Whether any US taxpayer or --

24 THE COURT: That was not my question.

25 My question was if that person was, as portrayed by

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1 the government, basically, a puppet whose only role in this
2 transaction was to make sure that the taxable income wound up
3 with somebody who was not subject to US income tax while US
4 taxpayers got the benefit, if that is all true, and if that
5 person was plugged in there for that reason, do you have any
6 doubt that there is something wrong with it?

7 MR. SCHEPER: Oh, I think it begs the question, your
8 Honor, under the law of agency and principle as to whether that
9 person fraudulently portrayed that person's status here. And I
10 don't think you'll find, whether -- hopefully, it is in a
11 separate case, never, but you won't find that there was any
12 disguising of what -- or certainly that was visible to
13 Mr. Pfaff as to what this person was. He was a nonresident
14 alien. And whether or not that person lied to taxing
15 authorities or to Philippine authorities, your Honor, it is not
16 the answer to whether that person was a bogus or fraudulent
17 nominee. But, to your Honor's other question --

18 THE COURT: But I thought the government's proffer on
19 this, essentially, is that Pfaff and Georgio cooked this whole
20 thing up, that they found the nonresident alien, and that
21 Georgio then proceeded to misrepresent the transaction to the
22 bank.

23 MR. SCHEPER: Well, your Honor, of course I can't
24 argue evidence with your Honor because Mr. Okula is proffering
25 what somebody might say if that person were called in a trial.

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1 so for me to niggle over whether I could impeach that or not, I
2 think representation that DeGiorgio would come into court and,
3 in the course of a direct examination, talk about summer
4 leasing, and maybe about his own winking and nodding in the
5 credit memo, I mean I get nowhere arguing whether he would or
6 wouldn't say that, or whether that is credible. What I can
7 speak to your Honor, is whether --

8 THE COURT: But what would be helpful for you to speak
9 to, instead of something else all together, is that if a trier
10 of fact were told by DeGiorgio that this is the way it went
11 down and believed him, do we agree that there was misconduct
12 here?

13 THE WITNESS: If a jury believed Di Giorgio's
14 admission that DeGiorgio wrote up a false credit memo that the
15 jury could properly conclude DeGiorgio engaged in misconduct,
16 to be sure.

17 THE COURT: If the jury believed that, if DeGiorgio
18 wrote up the false credit memo as part of a scheme that
19 involved Pfaff, and that part of the scheme that produced the
20 false credit memo also involved Pfaff and DeGiorgio or one or
21 the other or somebody in concert with them lining up a
22 nonresident alien to take the taxable income which would never
23 be tax paid income, would the jury be entitled to conclude that
24 the whole tax treatment and transaction was basically a sham
25 and that Pfaff was culpable in it?

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1 MR. SCHEPER: Well, if somebody said Pfaff is
2 culpable, a jury is entitled to that. That question, still,
3 your Honor, is --

4 THE COURT: Look, we're not getting anywhere, and I

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5 don't mean to give you a hard time. But I don't think you
6 are -- maybe I'm not being explicit enough. But I thought my
7 concern was indicated by my comment or question to Mr. Okula
8 about Justice Holmes or whatever. There are millions of people
9 around the country with -- perfectly, legitimately, and
10 lawfully, and properly arranging their affairs in such a way as
11 to avoid paying income tax. And it is fine. And the question
12 I ask Mr. Okula, is what provision of the Code what provision
13 of law says that if you plug in a nonresident alien as a
14 puppet, it is illegal. And he has at least promised to give me
15 authority on that.

16 So what I'm trying to get from you in the last ten
17 minutes is do you agree with that.

18 MR. SCHEPER: I don't agree that the facts here lend
19 themselves to a fraudulent use of a puppet by Mr. Pfaff.

20 I think what the facts here, and what a trial here
21 would show, is that whether the Philippine was or was not a
22 puppet, is a complicated question under the law. But I will
23 say, your Honor, if he says, I -- and I don't think a witness
24 can actually say: I was a puppet. But --

25 THE COURT: Depends on who is pulling the strings,
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1 doesn't it?

2 MR. SCHEPER: I guess so.

3 And but, actually, I think I take your Honor's point,
4 that there may well be something that would require some
5 explaining about that. And my point is that for a jury to get
6 the full picture about whether a 351 or 357(c) violation
7 occurred, it would need to get the whole story from all of the
8 players. And that is bank, and it's auditors, it's
9 accountants, it is US taxpayer, it is US taxpayer's advisor.
10 And to parachute that set of proofs into this case is, I think,
11 your Honor alluded to --

12 THE COURT: Look, I find that really absolutely
13 incredible. And totally consistent with the impression I came
14 to after wading through all of these papers. The government
15 did, in these papers, such a once over lightly that I ended the
16 whole thing having no idea what the evidence is, or why it is
17 relevant. And the only thing I got from defendants' papers is
18 that everything that ever happened that related to taxes in
19 America is in the case. If I allow the 404(b) evidence --
20 forget about why it is there. And I feel that I actually knew
21 much more about this before the motion was made. I mean I
22 don't believe the claims of incredible complexity from the
23 defendants because they are overdrawn and unsubstantiated at
24 this point, anymore than I believe the government's over
25 simplistic view.

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1 I'm looking for help.

2 MR. SCHEPER: No, your Honor. And, to that point, I
3 was not talking about complexity so much as I was talking about
4 length of time.

5 THE COURT: No, I don't believe that either. I mean I
6 don't know what to believe.

7 MR. SCHEPER: Well, what I think you can know, is that
8 the three witnesses that -- that the government has identified
9 who all agree were not witnesses to the charged conduct in the

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10 indictment, are named Moisen, Grandinetti, and Salas. And all
11 we know, your Honor, is that they're included on a witness
12 list. And then it is as if, well, by having them on the
13 witness list, I can then say that their description of one or
14 more of these pockets of additional uncharged conduct --

15 THE COURT: The government has said to me in substance
16 that Salas, the nonresident alien nominee is going to come in
17 here and say, I was recruited into this transaction that I had
18 never heard of, had no use for, had no interest in, and agreed
19 to sign papers that would be put in front of me for a \$25,000
20 fee.

21 AM I essentially right, Mr. Okula?

22 MR. OKULA: Yes, your Honor.

23 THE COURT: Okay.

24 Now, if those are the facts, give me one good reason
25 why it isn't probative of willful misbehavior by Pfaff and

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DeGiorgio.

1 MR. SCHEPER: I think, your Honor, it is. Logically,
2 it bears logical relevance. If believed.
3 I can't stand here and say, if believed, such
4 testimony is not logically relevant. My point is, I think it
5 is going to be a bigger trial within the trial, just as to
6 Mr. Pfaff. And I think there is seven other defendants who
7 have 404(b) exposure under the government's notices, just as to
8 Mr. Pfaff. It is going to take a lot of time -- and I'm
9 confident we'll do it -- to persuade that it doesn't show a bad
10 heart or a bad intent for Mr. Pfaff, that what it says about
11 other people's conduct may be a different question.

12 But I'm just talking, your Honor, against the
13 backdrop of this trial, all three of those witnesses, with
14 their multiple day, multiple hour interviews, every word they
15 uttered --

16 THE COURT: I'm sorry. What interviews are you
17 talking about?

18 MR. SCHEPER: I'm talking about the 3500 material of
19 those three witnesses. Every word they uttered is uncharged
20 conduct. So their very appearance in the courtroom for trial
21 is uncharged.

22 So it is an effort by the government to go beyond what
23 they charged about flip, opus, SOS, and blips. In other words,
24 none of those three say a word about those charged

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transactions.

1 In order -- just one of the eight defendants who has
2 this 404(b) exposure, in order for Mr. Pfaff to deal with just
3 summer leasing, we're talking about the Sherman & Sterling,
4 we're talking about the taxpayer himself, because what they
5 have to say will go to whether what Salas says is credible.

6 Was this really just something that was put upon you?
7 Is that really going to be credible at the end of the day, or
8 was this transaction sufficiently disclosed to the
9 participants.

10 And I think you'll find the same is true about the
11 UMBA Sands transaction. In that case, you had Deloitte &
12 Touche serve as auditors. And Mr. Okula talks about Mike,
13 Grandinetti as if he is this corporation. What else was going

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15 on in corporate HQ? Who else vetted this Sands transaction,
16 which I understand, and it is in the papers, and I think
17 everybody accepts as true, was a corporate tax advantage
18 investment opportunity in the mid 1990s in disputably marketed
19 by Mr. Hand and others.

20 So, my goodness gracious, there is UMBA Sands who,
21 among all those people, was fooled and put Mike Grandinetti's
22 now proffered testimony, in context.

23 Then, ask yourself what does this corporate play have
24 to do with whether or not 18 defendants conspired to aid
25 wealthy US investors and defraud the IRS with the four charged

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1 vehicles. And the other things -- I might as well mention it
2 now to save the revolving door to your Honor, is all of this
3 circles back from my client. And I hear Mr. Okula is
4 withdrawing the Scandia transactions. But just with respect to
5 his alleged fee from summer leasing and the like, which I think
6 he is going to say Mr. Salas is going to testify to in that
7 case, that's a question about whether we allow, and your Honor
8 in your discretion allow, a personal evasion case to be brought
9 within the context of the 18 defendant trial where there is not
10 any dispute, I don't believe, that all Pfaff moneys were paid
11 back or reported by 2001.

12 And there may be dispute about that. But a question
13 about the timing. And your Honor has read a lot about side
14 payments, and Mr. Pfaff not reporting. I don't know whether
15 DeGiorgio reported his side payments. Grandinetti reported
16 his. And Salas reported his. I just don't know from the
17 material yet. But, you know, Mr. Pfaff, it's a question of
18 when he reported. And the trial of Flip, Opus, SOS, and Blips,
19 should not evolve on the propriety of a reporting position
20 about whether liabilities matured on advance. These were
21 indisputably made but, also, indisputably reported.

22 THE COURT: All right. Thank you.

23 Anybody else on Somer UMDA.

24 MS. HOFFINGER: Susan Hoffinger, good afternoon, for
25 Mr. Ruble.

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1 Judge, the allegation against Mr. Ruble in terms of
2 the Sands transaction seems to be the following:

3 That he wrote an opinion letter, which the government
4 claims contained a misrepresentation about business purpose.
5 what I didn't hear from Mr. Okula's offers of proof was any
6 information about whether Mr. Ruble already proved that Mr.
7 Ruble knew that this loan never in fact occurred. Whether he
8 knew that, in fact, UMDA never wanted any of this low-cost
9 financing, despite the fact that there was a board resolution
10 from that company saying to the contrary. I think what's
11 related to that, your Honor, also, is there is -- this is going
12 to open up an entire new separate area at the trial about
13 whether in fact it is sufficient business purpose for a company
14 to say it wants to have low-cost financing that it couldn't
15 otherwise have. And that's an issue. I don't understand
16 Mr. Okula's proof that there was anything illegal about that.
17 And I think, you know, as a matter of notice, just to begin
18 with, I don't --

19 THE COURT: His position is if they didn't want the

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20 loan in the first place, why did they take it out?
21 MS. HOFFINGER: Well, I didn't hear anything from
22 Mr. Okula's description about Mr. Ruble being aware of that
23 when he wrote his opinion letter, not one thing. It was a
24 lengthy description. What I heard, was that Mr. Ruble wrote an
25 opinion letter on a transaction where he claimed that was

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1 business purpose based on UMDA wants to go have low-cost
2 financing, that was it.
3 I don't see anything illegal in that. And I think the
4 government is trying to get around that by saying, you know
5 what, at trial, all we're going to do is we're going to put up
6 a couple of guys from UMDA, one guy in particular, who is going
7 to say we didn't really want it and, therefore, it is going to
8 be a misrepresentation. And that's really all we have to
9 PROVE. But I don't think that is dispositive, Judge, because
10 to relate it, they are saying it is fraudulent for that reason,
11 that Mr. Ruble's opinion was fraudulent, and the transaction
12 was fraudulent. And the defense is going to be required to
13 contest the issue of whether this was a legal transaction or an
14 illegal transaction as the government claims.

15 So I think, you know, they are skipping over quite a
16 few steps, Judge, in saying that, you know, it is sufficient
17 for them to come in and say, you know what, the corporation
18 didn't really want it, despite the fact that they voted on it,
19 a number of members voted and issued a board resolution to the
20 contrary.

21 I think, also, as Mr. Scheper has indicated, Judge,
22 this was a very different transaction. I really don't see how
23 this relates to the four transactions at issue in the case. It
24 was a corporate transaction entered into by some of the very
25 large corporations in the United States. Along with, you know,

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1 all of the lawyers with them who vetted those transactions. It
2 involved the different tax treatment from the other
3 transactions, a different code provision. It is old. And,
4 Judge, I think, you know, for the government to say that the
5 similarity is, well, it was a misrepresentation, we're going to
6 say it is illegal, is just unfair. And, in the end, Judge, I
7 think this is just going to open up a whole new side show on
8 the Sands transaction

9 THE COURT: I understand that. All of the defendants
10 argue that. Believe me, I do. I'm trying to focus on what the
11 specific facts at issue are, and -- and the tax law here.

12 MS. HOFFINGER: So far, I have not heard anything
13 about specific facts against Mr. Ruble that would make it --
14 his opinion, illegal or fraudulent.

15 THE COURT: Okay.

16 MS. HOFFINGER: Thank you.

17 THE COURT: Thank you.

18 okay. Anyone else on defense side on this?

19 All right, Mr. Okula. Any parting shots on these two?

20 MR. OKULA: Just very briefly, your Honor.

21 We concede that there was no direct conversation
22 between Grandinetti and Pfaff and Ruble that we can point to.
23 With respect to Ruble's involvement as the opinion letter
24 writer in Sands. Our position, though, is the following: We

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25 will establish through the testimony of Grandinetti that there
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1 was no legitimate business reason for entering into the
2 transaction. And Grandinetti will also testify that his
3 supposed lawyer in the transaction, the person who has given
4 him his opinion, so he can use it for penalty protection and
5 use it for comfort of engaging in the transaction. He never
6 spoke to or met Ruble ever. So it is -- is it a fraud for
7 Ruble to write the opinion letter for this client while getting
8 business purpose from the person who is paying him a side fee.
9 That is our position, your Honor. And combined with, I think
10 the other proof in the case, where you're going to -- where
11 you're going to see, with respect to --

12 THE COURT: Upon whom is it a fraud?

13 MR. OKULA: It is a fraud to IRS. He is writing an
14 opinion for a transaction for a client and never speaks to the
15 client. And the proof with respect to Blips and Flip and opus
16 is going to be substantially similar to that, that he -- he
17 was never met and spoke with clients in these transactions, he was
18 just an opinion letter mill in exchange for a fee and -- I
19 think with respect to UMDA, when he is getting a side payment
20 from the promoter of the transaction who is feeding him the
21 business purpose.

22 THE COURT: But I can surely see that if the
23 government's argument was that there was a mail room wire fraud
24 here because the client was deprived of the honest services of
25 Ruble, in that Ruble was taking money from the counterparty and

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1 that that was not disclosed to the client and there was a
2 breach of duty to the client, that is an easy case. I think
3 that is -- isn't that Bronston? I mean it is -- certainly fits
4 the mold, anyhow. But maybe we're being more aggressive than
5 you can be in calling it a fraud on the IRS, no?

6 MR. OKULA: Well, I think for someone who is writing
7 an opinion for a transaction for a specific client where it is
8 integral for the tax result to occur, to know all of the facets
9 of the transaction, and to never have met or spoken with a
10 client with respect to the transaction, yet taking a \$250,000
11 fee and issuing an opinion --

12 THE COURT: Well, doesn't it depend on what the
13 opinion says?

14 MR. OKULA: It does.

15 THE COURT: I mean lawyers write opinions all of the
16 time and say -- say, in essence, we are advised that A, B, C,
17 D, E aren't true. Based on those assumptions which we have
18 made, no independent basis to verify, our opinion is X.

19 Isn't that perfectly appropriate legal practice?

20 MR. OKULA: I'm not sure in the context of this case,
21 your Honor, when you're relying on the business purpose from
22 somebody who is paying you an illegal gratuity. When Roy Hahn
23 is paying him a side fee, and he is not discharging -- he,
24 Ruble, is not discharging his duty about getting to the
25 bottom --

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1 THE COURT: But the duty, with respect to the -- the
2 duty that is being violated with respect to side payment, it is
3 the lawyer's fiduciary obligation of loyalty to the client,
4 isn't it?

5 MR. OKULA: It is. But I think in this situation,
6 your Honor, when you are taking a side fee, certainly there
7 should be some heightened awareness that, well, if somebody is
8 paying me a fee, a separate side fee for this, that is not
9 disclosed to my partners or the client, maybe I should get
10 behind a little bit, the representations that are being made,
11 in order to make this transaction go.

12 THE COURT: Does the IRS have as a -- I seem to
13 remember maybe the SEC does, but maybe not, rules of practice
14 for people who practice before the Internal Revenue Service?

15 MR. OKULA: I think there are rules of practice; yes,
16 your Honor.

17 THE COURT: All right.

18 Now, do those rules address the question of what the
19 level of due diligence required by an attorney giving a tax
20 opinion to a taxpayer is?

21 MR. OKULA: I can't stand here and say that I am
22 distinctly familiar with all of the provisions that require, or
23 say that you need, to how deeply you need to get into the
24 representations, your Honor.

25 THE COURT: And what about prohibiting side payments

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1 from conflicted parties?

2 MR. OKULA: Well, I think there are other provisions
3 that, criminal law, that speak to that more directly,
4 obviously. But I don't know about --

5 THE COURT: But then they are not charged here with a
6 scheme to defraud the client.

7 MR. OKULA: They are not, your Honor. I'm not
8 familiar with those, your Honor. I'll be happy to provide --
9 look tonight and provide you with authority in the wake of the
10 hearing.

11 If I may just make one more point with respect to Mr.
12 Schepers observation that everything with respect to Mr. Pfaff
13 was reported or ultimately reported. The facts would be, your
14 Honor, that once the IRS started its investigation --

15 THE COURT: I'm sure you don't have to belabor that.
16 That is obvious.

17 MR. OKULA: Just one last point, too, on Mr. Pfaff's
18 observation that we're going to have to prove everything with
19 respect to Sherman & Sterling, the United States taxpayer, and
20 everyone else.

21 Our position is quite simple. If there is one aspect
22 of knowledge, aspect that is critical to the transaction that,
23 if fraudulent, would defeat the tax results, that would solve
24 the transaction. And we're alleging the presence of Mr. Solas
25 as a pure puppet in the transaction. That is all you need to

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1 establish to make it fraudulent. And that is all we would
2 intend to prove. And I don't think it would create a big side
3 show.

4 THE COURT: All right. Thank you.

5 Well, from this model of clarity, let's move into the

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6 Permian Mud.
 7 Mr. okula, I guess will opine on that, too, huh?
 8 MR. OKULA: Our position with respect to the Permian
 9 Mud transaction is straightforward. Carol Worley was
 10 counseling a client that wanted to engage in a tax transaction.
 11 She learned during her counseling of the client that with
 12 respect to this specific tax results that the client was
 13 seeking, that Washington National Tax, with respect to the
 14 issues that were presented, could not get to a
 15 more-likely-than-not opinion.

16 Notwithstanding that, she directed that an opinion be
 17 prepared that was essentially a cut and paste from outside
 18 lawyers' opinions who ultimately, themselves, refused to sign
 19 off on the transaction, and told the client that the tax
 20 results they were seeking in the transaction was more likely
 21 than not.

22 Now, one thing that may be jumping out to your Honor
 23 is that we do have to prove this whole transaction, and is the
 24 tax law at place in the transaction critical, and will it
 25 create a big side show.

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1 I think the answer to that is, no, for the simple
 2 reason that it is an act of misconduct by Carol Worley to give
 3 an opinion in the transaction which he knows Washington
 4 National Tax, the person that she says in other paperwork in
 5 the case she relies on to give a specific tax advice, because
 6 she is not into the particulars of the tax advice. She
 7 testified to that at the suppression hearing. For her to go
 8 forward and to give a more likely than not opinion in a case
 9 where Washington National Tax said, as an entity, KPMG could
 10 not get there. And it is also for, keep in mind, that what she
 11 did was in order to --

12 THE COURT: You are overdrawing that a little bit,
 13 aren't you, because KPMG's internal structure gave individual
 14 partners the authority to give a more-likely-than-not opinion,
 15 provided the fee didn't exceed a million dollars.

16 MR. OKULA: Correct.

17 THE COURT: So --

18 MR. OKULA: And she purposely essentially structured
 19 the fee in what otherwise would have been a fee that would have
 20 warranted and required Washington National's tax review,
 21 structured it in such a way to escape Washington National Tax
 22 Review.

23 THE COURT: So I can see that maybe you have a
 24 persuasive argument here that she did something that was
 25 inappropriate in light of her obligations to KPMG.

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1 Now, if you just put aside, for the sake of discussion
 2 for a minute, the suppression hearing testimony which puts this
 3 in a different light, I acknowledge, if it was her honest
 4 belief that this was a more-likely-than-not transaction
 5 whatever Washington National Tax thought and, if out of loyalty
 6 to the client and appropriate professional motives she thought
 7 the right thing to do here was to quote a lower fee and give
 8 the client the opinion the client needed because, in good
 9 faith, she believed Washington National Tax was wrong, the best
 10 you have got is an argument that she played it fast and loose

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11 with KPMG rules, right, the very best.

12 MR. OKULA: I concede that, your Honor. I concede
13 that. And this proof, I think separate and apart from some of
14 the other proof which I think should come in in our direct case
15 viewed through the lens of what occurred at the suppression
16 hearing and what we anticipated her position to be at trial,
17 that is that: I was just a professional in the field that
18 relied for advice on Blips and all of these other transactions
19 on Washington National Tax, that if that is her defense, then
20 this is appropriate rebuttal proof by us that establishes or
21 belies her claim that I just relied on Washington National Tax.

22 THE COURT: Now, let's suppose that that is her
23 position at trial. And, on rebuttal, wants to use this.
24 Aren't you going to have to demonstrate some level of
25 comparability between Blips, Opus, SOS, and Blips on the one

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1 hand, and the Permian Mud transaction on the other, in order to
2 make it credible that her disavowal of appropriate level of tax
3 knowledge to form a view as the Blips and so forth, is the
4 substantial equivalent of a disavowal of knowledge with respect
5 to Permian Mud?

6 MR. OKULA: I think it would help to do that we would
7 be able to do that. And we will be able to show that there was
8 a precise overlap of issues, the critical issue. And I
9 apologize, your Honor, that we didn't get into more detail in
10 describing what one of the key tax plays was in Permian Mud.
11 But one of the tax plays -- in fact, one that was the subject
12 of the most debate, was the issue of 752 liabilities. That
13 is -- is something that is contributed to a partnership. In
14 this case, the client contributed an asset, had a partnership,
15 and was it a liability for 752 purposes which is the precisely
16 the size issue presented in the Blips transaction.

17 THE COURT: Okay. And if that is your view, doesn't
18 it mean that, in fact, you're going to have to prove the whole
19 Permian Mud saga in order to establish the comparability?

20 MR. OKULA: No. I think we would just have to prove
21 that Permian Mud involved that issue that -- and this is from a
22 witness who is already scheduled to testify at trial. A
23 manager who worked under Mr. Worley who is going to testify
24 that he was aware of the 752 being one of the critical, if not
25 the critical issue that outside lawyers could not get more

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1 Likely than not on it, that Washington National Tax could not
2 get more likely than not on it. He could not get more likely
3 than not on it. The reviewer of the transaction went looking
4 at it, said that he didn't find the writeup that this witness
5 did at Ms. Worley's urging on the 752 persuasive. And that's
6 all we have to prove with respect to that issue in the
7 transaction.

8 THE COURT: Is there a risk of unfair prejudice from
9 proof of this transaction in that the fact, if it be so, that
10 she played fast and loose, vis-a-vis KPMG, something which is
11 not necessarily very probative, if probative at all, of her
12 malefices with respect to Blips, Opus, and so forth.

13 MR. OKULA: I'm not sure I follow, your Honor.

14 THE COURT: What really arguably wreaks about this bit
15 of business is that she was misbehaving. If your proof is what

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16 you say it is, vis a vie KPMG, as much as if not more than
17 that, it tends to establish willfulness with respect to
18 transactions that are really at issue.

19 MR. OKULA: I think that is right, but I don't think
20 that is unfair prejudice, because what she is doing is going
21 forward. And this gets back to the issue that we think is most
22 probative on, is sort of rebuttal, is that she is going out
23 there on an issue where everybody is saying, no, we can't get
24 there. And she is touting herself, or is willing to
25 essentially give an opinion that the whole firm is saying no,

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1 that others are saying no, and she wants to bring the fee in.
2 She wants to bring it. And she does it through subterfuge.
3 Also, I think it is classic 404(b) with respect to -- with
4 respect to her knowledge and intent on the issues.

5 THE COURT: All right. Thank you.

6 Mr. Devita.

7 MR. DIVITA: Thank you, your Honor.

8 Your Honor what Mr. Okula is essentially saying is if
9 Ms. Worley had an honest disagreement on a very highly
10 technical professional matter with the Washington National Tax
11 office, she can be guilty of a crime in this transaction.

12 THE COURT: No, I thought what he said was exactly the
13 opposite. I thought what he said was that if there was legally
14 an honest disagreement, that it wasn't the problem here, but
15 the problem here is that she made it perfectly clear from her
16 testimony at the suppression hearing, and in connection with
17 those issues, that she really didn't speak tax to the extent
18 relevant to having an honest opinion on this subject and,
19 therefore, the fact what she circumvented Washington National
20 Tax really demonstrates something corrupt. I think that is
21 what he said.

22 MR. DIVITA: Okay. Well, your Honor, first, she
23 testified that in 1999 -- in 1998, when she was first coming
24 into this area and first pushed into this area by KPMG, she did
25 not have experience and technical knowledge with respect to

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1 these highly technical issues of partnership tax law, not that
2 she didn't speak tax.

3 THE COURT: I was being --

4 MR. DIVITA: I understand, your Honor. But it is a
5 very important distinction, because we're now talking three
6 years later after she has been assigned to what is called the
7 innovative strategies section of KPMG. She has had three years
8 of experience at regular meetings and discussions of these
9 various different technical issues. And her level of knowledge
10 and level of sophistication in 2002 and 2003 is significantly
11 different. And that is why the conduct in 2003 is not relevant
12 to her state of mind in 1998 and 1999.

13 Secondly, this is not as -- Mr. Okula is wrong when he
14 says nobody else could get to more likely than not on this
15 transaction, because there were other partners at KPMG
16 expressing the same view as Ms. Worely on this same subject.
17 There were two reviewers of this transaction, one of whom was a
18 former IRS and a former tax division lawyer who, if this
19 transaction was fraudulent, would never have signed off on it.
20 And she did. This is -- I'm not talking about Mrs. Worely.

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21 I'm talking about a former IRS and tax division lawyer who
22 reviewed the opinion letter and signed off on it and gave the
23 approval of it. And that is if this was a fraudulent
24 transaction, that would not have occurred. And she still works
25 for KPMG, that reviewer. So, Mr. Okula is simply not accurate

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1 when he says that nobody would go along with this.

2 In fact, the government's witness never says in his
3 3500 material that he believed this was a fraudulent
4 transaction. He disagreed on a technical issue. He did not
5 believe, more likely than not, in the -- and disagreed with
6 Ms. Worely on that, but did not say in his 3500 material, that
7 I saw, that it was a fraudulent transaction.

8 The specific -- if your Honor wants, I can get into
9 the technical aspects of this. But your Honor has indicated
10 some interest in that in the other transactions. In this one,
11 it is a very technical issue involving something called a
12 "prepaid variable share forward contract," similar to Delta
13 transaction that was talked about. But it is different. But
14 it does involve a taxpayer, or a company -- in this case,
15 again, it is a corporate as opposed to an individual
16 transaction -- that owns some shares that hedges the risk.

17 THE COURT: I think, on this transaction, it's not as
18 important as it is on the other.

19 MR. DIVITA: Fine. And, your Honor --

20 THE COURT: The government's position on this is very
21 simple.

22 MR. DIVITA: I understand that.

23 The other point, your Honor, is that I think it is
24 very unfair to say that she was deceiving Washington National
25 Tax, that she was somehow -- I mean the rule is that if the fee

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1 is under a million dollars, it does not require Washington
2 National Tax approval. It does not mean that anybody that --
3 that every fee has to be set above a million dollars. This was
4 a one-off transaction.

5 THE COURT: Let's be practical. If I were the
6 managing partner of KPMG and somebody quoted a fee of 995 in
7 order to get it under that rule because Washington National Tax
8 wouldn't bless the transaction, that person would probably have
9 a short career.

10 MR. DIVITA: Your Honor, I'm not convinced, as I
11 understand it, that Washington National Tax would not approve
12 an individual transaction of this nature. What Washington
13 National Tax -- and this was what was conveyed to the partners
14 if the field -- would not do, is agree that this transaction
15 could be adopted as a product that National -- that KPMG would
16 offer National. That does not mean that if the individual
17 transaction -- and, in fact, there were conversations with
18 people in Washington National Tax about aspects of this very
19 transaction. This went on for several months. And it was in
20 fact discussed both by the witness and by Ms. Worely with
21 people in Washington National Tax, certain aspects of this. So
22 this wasn't a renegade partner hiding in the wilds of Houston
23 doing something that nobody knew about. It was a transaction.
24 It was entered in their electronic filing system as a
25 transaction that was going to be taking place. It did not

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2 get -- the opinion letter did not get filed in a -- in the bank
3 of opinion letters because that would have violated -- that
4 would have destroyed the privilege that they were trying to
5 attach. If you circulate -- in a COVEL arrangement, you
6 circulate the opinion beyond the people working on the actual
7 opinion, you can blow the privilege that way. And that was --
8 that is the reason why it wasn't put in the data bank. It is
9 not as though this was hidden from Washington National Tax,
your Honor. That is just not accurate.

10 THE COURT: Okay. Thank you.

11 Let's go on to the quadruple bypass.

12 MR. OKULA: Your Honor, may I just circle back to one
13 issue that you raised earlier. And if -- I hate to cover all
14 ground, but I'm reminded by one of my colleagues of a provision
15 in Section 357 of the Code that basically says in Section B
16 that if there was not a bona fide business purpose in the
17 transaction, then 357(c) cannot be applied. And you can not
18 employ the transaction, so --

19 THE COURT: So that's the answer.

20 MR. OKULA: Pardon me?

21 THE COURT: I take it that is the answer to my
22 question.

23 MR. OKULA: Yes.

24 THE COURT: I Actually took that course in law school,
25 I want you to know that. But I don't remember the first word.

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2 There is one word I remember from that course.
3 MR. OKULA: Baseless.
4 THE COURT: Boot.
5 MR. OKULA: If I may, your Honor, our position on
6 triple bypass is quite simple. It was touted by David
7 Greenberg and sold by David Greenberg as a deferral mechanism.
8 And I think in the papers that the parties submitted there was
9 no doubt we're in agreement that it was depicted as a tax
10 deferral mechanism. And it was pitched to the client who sold
11 and appreciated assets that there were otherwise taxes going to
12 be due. Taxes were not paid because essentially asset was sent
13 through a series of transactions through a series of entities.
14 And what happened at the end of the day, is the consideration
15 that was received for the sale of the asset was held in an
16 entity and no taxes were paid because there was this promissory
17 note that was outstanding. And we're in complete agreement
18 that at the expiration period of the note, taxes would be due.
19 Our position on this is quite simple, that this was
20 touted as a deferral. But, in fact, the way it was employed,
21 the way David Greenberg talked to people about it and attempted
22 to sell it, was as a permanent mechanism to avoid paying taxes.
23 And what he would tell people is we're structuring it as a
24 deferral, but you can just create another note, and then
25 another note, and then another note, and not pay taxes at all
at the end of the day.

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1 THE COURT: Explain to me how that was supposed to
2 work.

3 MR. OKULA: If you start with the premise that the
4 note, for a stated term, at the end of the period of the note,
5 that the taxes would have to be paid --

6 THE COURT: When the note is paid?

7 MR. OKULA: When the note is paid, right.

8 But what Greenberg would talk to people about, and
9 what they would tell people, is that they would just create a
10 replacement note or extend the period of the note or alter the
11 note.

12 THE COURT: Right, so what?

13 MR. OKULA: Well, taxes never get paid then. At the
14 end, it just keeps going on and on and on.

15 THE COURT: Look, sooner or later, something happens.
16 I take it that the taxpayer is not directly selling the asset.
17 Right?

18 MR. OKULA: Right.

19 THE COURT: The asset is owned by a controlled entity.

20 MR. OKULA: Correct.

21 THE COURT: And the controlled entity sells the asset
22 to a third party.

23 MR. OKULA: Yes.

24 THE COURT: And gets cash --

25 MR. OKULA: Correct.

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1 THE COURT: -- presumably. And the controlled entity
2 gives a note to the taxpayer, right?

3 MR. OKULA: Correct.

4 THE COURT: And the taxpayer, through the control of
5 the controlled entity, has certainly a lot to say about what
6 happens to the cash in the interim. True?

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7 MR. OKULA: Yes.
8 THE COURT: So suppose the note starts out at six
9 years and gets extended to 12 years, gets extended to 18 years.
10 You're saying that what they were going to do is just extend
11 the note forever?

12 MR. OKULA: Yes. There were discussions along those
13 lines, that you just keep rolling over the note. In fact, with
14 respect to a witness --

15 THE COURT: Let me ask you this. What happens with
16 respect to the estate taxation upon the death of the taxpayer?

17 MR. OKULA: I think it would pass --

18 THE COURT: How is the note valued in the estate?

19 MR. OKULA: I'm not sure, your Honor.

20 THE COURT: Does it matter?

21 MR. OKULA: I'm not sure we have to get into that.

22 THE COURT: I think maybe we have to get into it
23 unless we're prepared to give the taxpayer eternal life.

24 MR. OKULA: No, but I think what is important is
25 noting, I think, that David Greenberg, when he was selling the

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1 transaction, would just tell the people, just keep passing it
2 along and along and not pay taxes, on the transaction, and so
3 he's evincing his intent, I think -- I'm sorry if I'm not
4 answering your question directly, your Honor.

5 THE COURT: You're not. I understand that point. But
6 it just doesn't make any sense because everybody knows things
7 don't go on forever, at least in this life. So the taxpayer,
8 sooner or later, is going to die. And in his estate he's got a
9 note which I think in this transaction is, what, a hundred and
10 some million dollars?

11 MR. OKULA: That's correct.

12 THE COURT: All right. So certainly it is a matter of
13 relevance to the taxpayer as to what the treatment of the note
14 on death is, don't you think?

15 MR. OKULA: Yes.

16 THE COURT: So what is the treatment?

17 MR. OKULA: I'm not sure, your Honor. But --

18 THE COURT: Now, aren't there circumstances that occur
19 all the time where, without any fraud, without any shenanigans,
20 people have assets, appreciated assets, where as long as they
21 don't sell or otherwise realize on the asset during life, they
22 die, the asset is then valued in the estate, estate tax is
23 paid, to the extent it's payable, and there's a step-up in the
24 basis of the appreciated asset and there's no capital gain ever
25 paid. Right?

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1 MR. OKULA: I think there are circumstances where that
2 occurs, yes, your Honor.
3 THE COURT: Like any time anybody buys a house.
4 MR. OKULA: That's correct. One of the fraudulent
5 aspects of this transaction, though, what David Greenberg would
6 tell to the people, is that you can use, and he knew that the
7 taxpayer that he sold this transaction to, the California real
8 estate investor who sold his business, that you can simply
9 control and use the assets without recognizing the tax
10 liability.
11 THE COURT: But you've got to be a little bit more

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12 critical, I think, of what that means in the context of the
13 transaction. If the taxpayer is the decision maker for the
14 entity, surely he controls the assets. Right?

15 MR. OKULA: That's correct.

16 THE COURT: Nothing wrong with that, right?

17 MR. OKULA: That's correct.

18 THE COURT: He can control it for the whole six years,
19 even if the note gets paid in year 6, but he's not paying tax.

20 MR. OKULA: That's correct, but if he employs some of
21 the assets, some of the consideration that is received during
22 the existence of the note, tax is supposed to be recognized
23 during that period of time.

24 THE COURT: Define "employs."

25 MR. OKULA: If he uses for personal purposes.

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1 THE COURT: Yes.

2 MR. OKULA: Takes it out of the entity that he
3 controls, using it for personal purposes to pay living
4 expenses.

5 THE COURT: If he takes it out of the entity.

6 MR. OKULA: Yes.

7 THE COURT: Isn't that a partial repayment of the
8 note?

9 MR. OKULA: No.

10 THE COURT: Why not?

11 MR. OKULA: Because the note is structured in such a
12 way that the note payments have to be made to the entity.
13 Taking the money, the cash, out is not a repayment of the note.

14 THE COURT: The note is from the taxpayer to the
15 entity?

16 MR. OKULA: Yes.

17 THE COURT: I thought the taxpayer sold assets to the
18 entity in exchange for a note, a note of the entity payable to
19 the taxpayer.

20 MR. OKULA: I'm not sure that that's the way it goes,
21 your Honor. I think that there is the existence of the note
22 which has to be repaid at the end, but taking the assets,
23 taking the appreciated assets, the cash, out of the entity
24 doesn't serve to repay the note. That's a fundamental point.

25 THE COURT: Don't we at least have to agree on who the

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1 maker and who the payee of the note is before we can even
2 approach that question?

3 MR. OKULA: Yes, your Honor.

4 THE COURT: And we don't know? Is that what you're
5 telling me?

6 MR. OKULA: I think your Honor had it right when your
7 Honor said, I think I misspoke with respect to the maker and
8 the payee.

9 THE COURT: Okay. So the entity, XYZ company, has a
10 note payable to the taxpayer for x million dollars, \$120
11 million. Now, certainly for the six years, I take it the
12 government agrees that if the intention all along was the note
13 gets paid in year 6, there is no problem, right?

14 MR. OKULA: Correct.

15 THE COURT: Okay. Now, within that six-year period,
16 on that assumption, the taxpayer totally controls the money

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17 because he controls the entity that has possession of the cash,
18 doesn't affect the tax treatment, right?

19 MR. OKULA: That is correct.

20 THE COURT: Now, within the six years, the taxpayer
21 decides he wants \$10 million to buy a small apartment in
22 Manhattan. And he wants to take the \$10 million out. Now, if
23 he simply writes a check on the entity, either to himself or
24 for his own benefit, to whoever is selling the condo, he's got
25 to have some kind of accounting treatment and tax treatment for

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1 that \$10 million payment, right?

2 MR. OKULA: Yes.

3 THE COURT: All right. Now, one way it can be done is
4 it can be a partial repayment of the note, right?

5 MR. OKULA: I don't think so, your Honor.

6 THE COURT: Why not? If the entity owes him \$120
7 million and pays him 10 million, why isn't one possible way to
8 do it to say the entity now owes him \$110 million? Maybe that
9 note's been hypothecated or something. I don't know, but --

10 MR. OKULA: I think that that's the answer, that it
11 has been hypothecated, but I know that -- well --

12 THE COURT: I didn't see that in your discussion of
13 the transaction.

14 MR. OKULA: No. And I know that we did not get into a
15 lot of the particulars of all the different layers involved in
16 the transaction. But it's my understanding, your Honor, that
17 any time the money is taken out from the entity that controls
18 the cash, and I can't give you the precise provision of the
19 loan agreement or the rationale why it's so, but it says so in
20 the opinion letter, and it says so in the documents that are
21 given to the taxpayer going forward entering into the
22 transaction, that if you take money out, beforehand, and you
23 get control of that money, it's a taxable event to you, before
24 the expiration of the period of the note.

25 THE COURT: Regardless of how it comes out?

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1 MR. OKULA: Correct.

2 THE COURT: If that's what it says in the opinion
3 letter, do we have a view as to whether it's right?

4 MR. OKULA: I think we have to deal with whether it's
5 right, yes, your Honor.

6 THE COURT: Is it right?

7 MR. OKULA: I think it is right, what it says in the
8 opinion letter, that when the money comes out, it is a taxable
9 event to you. And I don't think there's any disagreement that
10 if money in the entity that gets the cash upon the sale of the
11 appreciated asset goes to the taxpayer before the expiration of
12 the event is a taxable event to the taxpayer.

13 THE COURT: Suppose the entity loans the 10 million to
14 the taxpayer?

15 MR. OKULA: Well, I think if it's surrounded by
16 appropriate documentation indicating that it's a true bona fide
17 loan.

18 THE COURT: He pledges his first born.

19 MR. OKULA: I think if there's a bona fide, legitimate
20 loan.

21 THE COURT: Maybe it's not a taxable event.

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22 MR. OKULA: Correct. But it depends on how it's done,
23 and what is said to the taxpayer, and if it's the case, as I
24 believe it to be so, that if it's not a loan but you're simply
25 taking the money out to use it for your own purposes, personal

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1 living purposes as this client of David Greenberg did, then
2 it's a taxable event. And there was no --

3 THE COURT: And presumably it's a taxable event to the
4 extent of whatever fraction of the \$123 million the money
5 coming out bears to the total, right?

6 MR. OKULA: Yes.

7 THE COURT: So you don't lose the whole tax deferral;
8 you lose some proportion of it?

9 MR. OKULA: That's correct.

10 THE COURT: All right. Now, that's what I would have
11 expected. Now, if that's the case where everybody agrees it's
12 going to be paid in year 6, what's the problem if it goes to a
13 renewal note or an extension of the note?

14 MR. OKULA: I think if you keep extending and
15 extending and extending and never intend to pay the taxes on
16 it, and it keeps going forward, then that's improper.

17 THE COURT: Why? What if you have a house that you
18 bought for half a million dollars and it's now worth two and a
19 half million dollars and you just keep not selling it, because
20 you don't want to pay the capital gains tax and you'd rather
21 the kids get it with a stepped-up basis when you go to the
22 great beyond. Fraud?

23 MR. OKULA: No.

24 THE COURT: I didn't think so, at least I hope not.
25 If you're having this much trouble answering this

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1 question to me in this hearing, what are we going to do with a
2 jury? I'm really dead serious about that.

3 MR. OKULA: I understand, your Honor. I understand.
4 But our essential position is if it's pitched as a deferral and
5 if you understand implicit in the tax treatment is that you
6 cannot make personal use of the funds, David Greenberg tells
7 people you can make personal use of the funds, they make
8 personal use of the funds, do not pay taxes on it, if it's
9 pitched as a deferral, and he tells them don't worry about
10 taxes, they'll never have to be paid on this transaction, when
11 everybody knows that if it's a deferral, taxes have to be paid
12 on the transaction, then it's our position that that's fraud.

13 THE COURT: What is the fraud exactly?

14 MR. OKULA: Because they're making personal use of the
15 funds that are in the entity without recognizing that as
16 income.

17 THE COURT: So you're saying the opinion letter says
18 that if you take money out, it's a taxable event to you, the
19 taxpayer, and that taxpayers are taking money out and making
20 personal use without declaring the income? Is that what you're
21 saying?

22 MR. OKULA: Yes.

23 THE COURT: And maybe that is a fraud, but maybe it's
24 a fraud by the taxpayer, huh?

25 MR. OKULA: Or as one urged by David Greenberg or

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2 discussed with David Greenberg as a mechanism that they could
3 employ in this deferral shelter.

4 THE COURT: So is it your position that there's really
5 nothing wrong with the shelter, the problem is that Greenberg
6 is urging that the taxpayers not report income which, under the
7 terms of the opinion letter, which presumably he procured, it
had to be reported and tax paid?

8 MR. OKULA: Correct.

9 THE COURT: And what's the evidence of that?
10 MR. OKULA: That one of the taxpayers who discussed it
11 with David Greenberg, who was pitched this deferral tax
12 shelter, and who David Greenberg later sold an SOS tax shelter,
13 discussed the fact that money was coming out to pay this
14 person's personal living expenses, and David Greenberg then
15 referred him to use as an accountant the same accountant that
16 he and Mr. Goddard employed in preparing the tax returns for
17 the SOS tax shelters, and he knew that money was being used for
18 personal purposes and not reported.

19 THE COURT: This is really not what your brief says,
20 unless I missed something. I understood your brief to argue
21 that there was a fraud here because Greenberg told the clients
22 that the notes could be extended repeatedly through the
23 client's death and then it would pass to the heirs and the gain
24 would not be subject to income tax.

25 MR. OKULA: That is part of it, yes, your Honor.

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2 THE COURT: Is it fraudulent to say the note could be
3 extended?

4 MR. OKULA: I think it could be extended only for the
5 stated period at the beginning, that is set at the beginning of
the transaction.

6 THE COURT: Why?

7 MR. OKULA: It's my understanding that the tax
8 treatment relative to that required that, your Honor.

9 THE COURT: Where does that come from?

10 MR. OKULA: From my understanding of the documents and
11 the way that this was pitched and portrayed.

12 THE COURT: Look, the tax consequences don't follow
13 from the way it was pitched and portrayed. They follow from
14 the documents in the Internal Revenue Code.

15 MR. OKULA: I understand that.

16 THE COURT: I don't get it.

17 MR. OKULA: Perhaps we could make a supplemental
18 submission on this, your Honor.

19 THE COURT: I think you're going to have to.

20 Let me hear the defendants' side, because it should be
21 a lot more enlightening.

22 MR. CASSMAN: Ted Cassman, appearing on behalf of
23 Mr. Ritchie.

24 One of the salient points that I think marks the
25 discussion that I just heard between the government and the

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2 Court is that while they're talking about a triple bypass
transaction, they never once talked about the transaction that

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3 Mr. Ritchie and his employer participated in. And they haven't
4 described it to the Court. And, in fact, in their papers when
5 they discussed this transaction, they discussed one that
6 involves a living taxpayer, as the Court was discussing. That
7 didn't exist in the Delta reorganization that we've submitted
8 to the Court. And the fact of the matter is, the reason is
9 this. Each of these transactions was a uniquely designed
10 transaction for individuals, by Mr. Greenberg and KPMG. You
11 heard no evidence, by the way, of how it was pitched to Mr.
12 Ritchie.

13 THE COURT: Is this Delta reorganization, is that not
14 the same thing as the Global Crossing transaction? Or is it
15 the same thing?

16 MR. CASSMAN: That is the Global Crossing transaction,
17 related transaction.

18 THE COURT: I thought so.

19 MR. CASSMAN: The government calls it a triple bypass,
20 and then they tried to, in their papers, through the back door,
21 bring in yet another transaction under 404(b), which they
22 didn't move to admit into evidence, and they talk about witness
23 No. 1, Mr. Sands, and his transaction. His transaction was
24 designed by Mr. Greenberg, apparently, and was a separate
25 transaction involving a live taxpayer.

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1 In our case, we do have a redemption note between two
2 entities, Delta One, and Pacific Capital Group. It was a real
3 redemption note, a real loan. It acted like a loan, it walked
4 like a loan, it was a loan. It was \$138 million redemption
5 note. It was properly documented on both the companies' books.
6 It was carried on the books, it required that interest be
7 EITHER paid annually or accrued annually, and in 2002 and 2003,
8 Delta made the decision to accrue it annually.

9 In December 2004, Delta One made a decision to make a
10 payment on the loan. It made a \$104 million payment on the
11 loan. \$80 million was principal, 24 million was interest. It
12 was reflected on both the books, and Pacific Capital Group
13 recognized the income on its books and paid a portion of it in
14 taxes. It was able to also write it off against other gains.

15 The important thing here, your Honor, is this, that
16 everything that Mr. Okula has said to the Court is a
17 hypothesis. It's his gloss on the evidence. It's not reality
18 based in the facts of the transaction that occurred.

19 They say that they intend to establish this
20 transaction with one hour of testimony, less than an hour of
21 testimony, and they said they're going to do it based on
22 statements, but the statements don't bear it out. They will be
23 intensely litigated. There will be extensive argument and
24 presentation of evidence on this matter. But the important
25 point is this: They cannot establish any invalidity to this

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1 transaction without the facts. And the facts are as I've
2 described them to the Court, very simple and straightforward on
3 that level. It was a loan, it was repaid, and income was
4 recognized on the company's tax returns.

5 THE COURT: I don't know if it was your brief or
6 someone else's, but someone sought to defend, I believe, this
7 transaction, by saying that it accomplished a series of

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8 business purposes. The first was that it locked in some
9 appreciation on the Global Crossing stock. Secondly, that the
10 taxpayer obtained immediate liquidity. Thirdly, there was a
11 retention of some of the upside. Fourthly, Unified was
12 permitted to pay down some debt, and there was a risk in that
13 the transaction might have to be closed if Global Crossing were
14 delisted, which I suspect may have happened. Right?

15 MR. CASSMAN: That's correct.

16 THE COURT: Explain to me what the upside was for the
17 taxpayer in this transaction.

18 MR. CASSMAN: At the time this transaction was entered
19 into there was limited upside.

20 THE COURT: Which means zero.

21 MR. CASSMAN: Perhaps.

22 THE COURT: I'm sorry. It's not perhaps. It's either
23 yes or no.

24 MR. CASSMAN: It was November 2001. It didn't look
25 good. It was clear, in everybody's minds, that there was real

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1 problems for Global Crossing. It went bankrupt January 2002.
2 THE COURT: Suppose they had discovered commercially
3 feasible nuclear fusion that month. How in the structure of
4 this transaction was there an upside?

5 MR. CASSMAN: The upside was this. If Global Crossing
6 recovered, it was admittedly a patient on a potential death
7 bed, but if it recovered and if the value of stock exceeded
8 that in the VSF contract, if that occurred, there was a
9 potential upside.

10 THE COURT: Yes. You've just told me again that there
11 was an upside, and the question was how.

12 MR. CASSMAN: If the value of Global crossing stock
13 exceeded the value of the variable share forward contract,
14 there was an upside.

15 THE COURT: Now, under the variable share forward
16 contract, Global was required to buy the stock three years
17 hence at \$15 a share, correct?

18 MR. CASSMAN: Correct.

19 THE COURT: If the stock went up to 170, you think
20 Global would have done it?

21 MR. CASSMAN: Correct.

22 THE COURT: What sense does what you're saying make?

23 MR. CASSMAN: Oh, I see the Court's point. Oh. The
24 potential upside was this, that, where there's five more
25 million shares, your Honor, that are still owned by the

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1 taxpayer at that point, that are unencumbered.

2 THE COURT: Which wasn't a part of this at all, right?

3 MR. CASSMAN: It was --

4 THE COURT: At the beginning.

5 MR. CASSMAN: At the beginning, that's correct.

6 THE COURT: So there was no upside in the transaction
7 as it started out.

8 MR. CASSMAN: With the variable share forward
9 contract.

10 THE COURT: Right.

11 MR. CASSMAN: Right.

12 THE COURT: And everything else that was said in

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13 defense of the transaction as it started out was easily
14 achieved by selling the stock. Right? If you simply went out
15 and sold the stock, the appreciation is locked in, the
16 liquidity happens, there's no upside either way, and the money
17 was available to allow Unified to pay down debt.

18 MR. CASSMAN: And its tax liability is immediately
19 recognized, correct.

20 THE COURT: Right. So the only reason to do this as
21 it started out was to avoid the tax liability.

22 MR. CASSMAN: With the Delta One transactions.

23 THE COURT: Yes.

24 MR. CASSMAN: There's a second reason, and that's
25 asset protection.

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1 THE COURT: Asset protection, meaning what?

2 MR. CASSMAN: Yes, sir. Meaning that it was
3 anticipatable that there would be claims made against PCG, and
4 this was an effort to protect those assets.

5 THE COURT: PCG being?

6 MR. CASSMAN: Pacific Capital. It's actually the
7 taxpayer.

8 THE COURT: Right, the winning entity.

9 MR. CASSMAN: That's correct.

10 THE COURT: So there was a tax motive and a fraud on
11 creditors' motive, basically.

12 MR. CASSMAN: That's not correct, your Honor. And
13 this transaction was fully vetted by attorneys both beforehand
14 and afterwards during the bankruptcy.

15 THE COURT: I've held a couple of those unlawful up to
16 now, under fraudulent conveyance law.

17 MR. CASSMAN: With regards to the Global Crossing
18 case?

19 THE COURT: Not speaking of Global Crossing.

20 MR. CASSMAN: I'm talking about this transaction, your
21 Honor. It was fully vetted.

22 THE COURT: What I'm saying to you is lots of
23 transactions that have been fully vetted have been held to have
24 been fraudulent conveyances.

25 MR. CASSMAN: It was fully vetted both beforehand and

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1 afterhand, in the context of bankruptcy, and there was no
2 allegation by anyone that this was a fraudulent conveyance.

3 THE COURT: All right. Anything else on this?

4 MR. CASSMAN: No. I don't believe so.

5 THE COURT: All right. Yes.

6 MR. DeVITA: Your Honor, just one point of difference,
7 so your Honor is not left with a misimpression with respect to
8 the Permian Mud variable forward contract.

9 There was, in fact, both an upside and a, it was a
10 transaction that where the upside, the purchase price would be,
11 that the taxpayer retained part of the ability to share in the
12 appreciation before the end of the contract and also a small
13 part of the risk, but it limited the range.

14 THE COURT: There was a contract.

15 MR. DeVITA: A form of contract.

16 THE COURT: I don't think a variable share forward
17 contract is a dirty word, necessarily.

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18 Anybody else on this?
19 Okay. Let me go back over my notes.
20 It's perfectly clear to me on the basis of what I have
21 up to now I can't even begin to express an intelligent opinion
22 about the so-called triple bypass because I don't know what the
23 proof the government wants to offer is, and I don't really know
24 why the government thinks that whatever that proof might be
25 establishes that anybody did anything wrong, let alone anything

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1 wrong that's relevant to this case.
2 Now, with respect to Permian Mud, I think I'm more or
3 less in the same place, although the facts are obviously a lot
4 simpler. And I think the same is true for the Somer Leasing
5 transaction and, to a very limited extent, the UMDA
6 transaction. So I'm going to give you all a chance to have at
7 this again. I want to know exactly what the evidence is the
8 government relies on. I want to see the documents. And I want
9 the ABC of the tax law on it. This doesn't make any sense to
10 me without that.

11 Two weeks enough time, Mr. Okula?

12 MR. OKULA: Yes, your Honor.

13 THE COURT: All right. Then the defense will have two
14 weeks after that. And we'll go back to square 1 on all of it.

15 In the last analysis, Mr. Okula, I think that I'm
16 bending over backwards to give the government a full
17 opportunity to make this clear, but it's the government's
18 burden, and at the end of the day, if it's not clear, you're
19 not going to get it in.

20 MR. OKULA: I understand that fully, your Honor.

21 THE COURT: Okay. All right. Now I'll hear whatever
22 anybody wants to say on the remaining issues, the personal tax
23 evasion and the side fee issues. We'll start with the
24 government.

25 MR. OKULA: Starting first with defendant Ruble, your
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1 Honor, he is charged with receiving side fees for a number of
2 years. There is substantial proof that in the years '96 and
3 '97, just like in the years '98, '99, 2000, 2001, he received
4 secret payments from tax shelter promoters. He did not report
5 them on his tax returns, at all, for the '96 to '97 years, and
6 they were not, they were hidden in the evasion that he carried
7 out from his partners at Brown & Wood, effectuating the evasion
8 scheme. And I think that unless Mr. Ruble unequivocally
9 consents or indicates that intent and knowledge are not an
10 issue with respect to the willfulness element for the charged
11 years, then his proof of the unreported fees received during
12 those years, I think, speaks volumes about what his intent was
13 in the charged years.

14 The issue in the form of proof, your Honor, two
15 witnesses who are already slated to testify, we'll just produce
16 the additional proof with respect to the payments that went to
17 Mr. Ruble during the '96 and '97 years, those were categorized
18 by the entities as consultancy fees to him, and there were no
19 tax-reporting documents that were issued to him. Some of the
20 payments that were made by the tax shelter boutique in New York
21 did not issue tax-reporting documents because the head of the
22 tax shelter boutique directed his controller not to issue 1099s

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23 to Mr. Ruble, and we're going to be able to establish that this
24 person was a close confidant and friend of Mr. Ruble. So I
25 think it's highly relevant to the issue of knowledge and intent

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1 for the charged years where he's charged with failing to report
2 fee income.

3 THE COURT: okay. Move on, because we have about
4 another 20 minutes or so, for everybody.

5 MR. OKULA: With respect to Mr. Greenberg, the proof
6 is very straightforward, your Honor, that he did not report
7 tens of millions of dollars of income that he made pursuant to
8 the fee-splitting arrangement with Mr. Goddard. It never hit
9 his personal returns. We can present that proof in a
10 streamlined fashion in a significant measure by the documents
11 that he submitted in connection with the bail hearing, where he
12 acknowledged that this money --

13 THE COURT: If that's a streamlined fashion, you're in
14 trouble.

15 MR. OKULA: I agree. It was not a streamlined bail
16 hearing, but I'm referring your Honor to a written analysis
17 that was presented to the Court by his accountant acknowledging
18 essentially his receipt for the garnering of those fees with
19 Mr. Goddard during the years. Initially, Mr. Acosta will
20 testify with respect to the receipt of fees during those years
21 also.

22 There's also the very straightforward proof with
23 respect to how he did not report accurately his income from
24 Deloitte & Touche and KPMG in two years where he essentially
25 put nominee on his return and did not recognize it on his own

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1 income tax return. You can't assign your income. I know that
2 principle of law, your Honor, and that's essentially what he
3 did. He did not recognize it for two years on his return, and
4 for two other years when he got K1s from KPMG noting over \$1.5
5 million in income, he essentially created phony losses that he
6 put on the return to offset the taxability of the income. It's
7 very straightforward. It speaks volumes about his knowledge
8 and intent, and I think it's highly relevant.

9 With respect to Mr. Hasting, your Honor, I want to
10 correct something we said in the brief with respect to evasion.
11 I think it could be more accurately categorized as a false
12 return, rather than evasion. There was no tax due and owing,
13 we concede that point, as a result of how it was depicted or
14 reported to the IRS. But this is what we'd be able to prove
15 with respect to Mr. Hasting.

16 Mr. Hasting was referring clients to a tax shelter
17 boutique called Gramercy. Mr. Hasting himself engaged in a tax
18 shelter transaction with Gramercy and had an entity that he
19 created in order to effectuate that transaction with Gramercy.
20 Because Mr. Hasting referred clients to Gramercy, the principal
21 of Gramercy essentially gave a \$75,000 thank you to
22 Mr. Hasting. That \$75,000 should have been reported as fee
23 income on Mr. Hasting's 1040; it was not. Instead, and
24 Mr. Hasting knew this at the time, he knew it during 2002,
25 because he had discussions with the principals of Gramercy at

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 2 the time, he knew that it was not going to be reported to him
 3 in an individual way, and that in fact it was going to be
 4 buried in the K1 that Gramercy issued to him in connection with
 5 his own transaction. So it's a false reporting issue with
 6 respect to Mr. Hasting. Very straightforward. He should have
 7 reported his kickback. He didn't, by the way, report it to his
 8 partners at KPMG, which he should have, which is one of the
 9 methods by which he concealed it and carried out his false
 depiction on his return.

10 I think that completes the personal evasion, except
 11 with respect to Mr. Pfaff, your Honor. We will be able to
 12 prove, your Honor, through Mr. Romero Salas, through
 13 Mr. Grandinetti, and through Mr. Moisen that between 1996 and
 14 -- well, it was a little bit earlier. In fact, it started
 15 around '94, '95, but continuing to the year 2000, that
 16 Mr. Pfaff received over \$2.5 million in unreported fees, much
 17 of which he hid from his partners at KPMG, did not report to
 18 them, and it was paid to Mr. Pfaff as a result of tax shelter
 19 transactions that he, Moisen, and others set up. It was
 20 filtered to him through Mr. Salas in the Philippines, that is
 21 when the transactions, which were largely domestic, there were
 22 some that occurred off-shore, but these largely domestic tax
 23 shelter transactions would result in a payment to the promoters
 24 which was sent to Mr. Romero Salas in the Philippines. Then
 25 Mr. Romero Salas, upon request by Mr. Pfaff and Moisen and

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 2 Grandinetti, would distribute the fees to the promoters,
 3 including Mr. Pfaff.
 4 Mr. Pfaff did not report it contemporaneously. It was
 5 used for all of his personal purposes, to buy houses, to buy
 6 cars, and he attempted to paper over his receipt of the fees
 7 when the IRS investigations start. That is, he went to
 8 Mr. Grandinetti, and he got together with Mr. Salas too, really
 9 through Grandinetti, and they create a series of phony loan
 10 documents to make it appear as if the money that he had
 11 previously received as fees and which was not reported on his
 12 returns was part of a lending relationship.

13 There's also coconspirator statements that we intend
 14 to elicit that Mr. Pfaff told people during these years, that
 15 if the IRS ever came knocking at his door, what he was going to
 16 do was reach down, pull out the note and say it's not income to
 17 me, it's just all part of a big lending relationship. And
 18 Mr. Salas, Mr. Grandinetti, and Mr. Moisen will all testify
 19 that they received significant amounts of income from this
 20 agreement that they had with Pfaff, and we'll be able to prove
 21 that Mr. Pfaff got the same thing also.

22 In fact, the proof with respect to Mr. Pfaff, he's not
 23 contesting the fact that he received all this income, or
 24 received all this money. What he's contesting and what will be
 25 the sole dispute, I think, with respect to his receipt of the
 fees is, was it income or was it a loan. And the witnesses

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 2 will say it was demonstrably not a loan.
 3 Unless the Court has any additional questions, we'll
 rest on our papers.

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4 THE COURT: Thank you.
5 Defendants.
6

7 MR. PITOFSKY: I'll try to be brief.
8

9 First of all, I would assume that if the court permits
10 further briefing on these topics from the government, it will
11 make a similar request that the government explain exactly what
12 provisions of the tax code prohibit the treatment that
13 Mr. Greenberg and the others gave to their personal returns.
14 There are assertions made that it's unlawful, but, again,
15 there's no clear statement by the government about what makes
16 it unlawful. So it's hard to join issue with them on whether
17 this was lawful or not.

18 My second point, and I know the Court doesn't want to
19 get --

20 THE COURT: I suspect in this case it deals with
21 section 61 of the code.

22 MR. PITOFSKY: Well, we'd like some clarification on
23 it so we can join issue with it. I know the Court.
24

25 THE COURT: Is that right, Mr. Okula?

MR. OKULA: Yes, it is, your Honor.

MR. PITOFSKY: I know the Court doesn't want to get
25 into the case law too much, and I won't, but having looked at

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1 the cases about the admissibility of a failure to file or
2 underreporting of personal returns as 404(b) evidence, what we
3 see is cases in which taxpayers are on trial for that kind of
4 violation, they're charged with failing to report or failing to
5 file. They make some defense in the nature of it was a
6 mistake, it was an accident, it was inadvertent, and then the
7 prior failure to file is admitted to show or at least to give
8 the inference that that's not really right, that you can
9 conclude that this was a pattern and not just a mistake.

10 The problem in this case is the government's
11 articulated no reason, and it's elicited no cases to justify
12 why the personal tax evasion would be admissible in this
13 complicated tax shelter case.

14 THE COURT: Because if somebody's chiseling on his own
15 returns, it makes it marginally more likely that he's chiseling
16 on somebody else's. It's not that hard, Mr. Pitofsky.

17 MR. PITOFSKY: I think that starts to lean just toward
18 propensity evidence. The cases are fairly clear.

19 THE COURT: It tends to suggest chiseling in the sense
20 of willfully doing it, intending to do it.

21 MR. PITOFSKY: I understand. But, again, it seems to
22 smack of propensity to cheat one's taxes. The cases are fairly
23 clear that that's not enough. There's no case that stands for
24 that broad proposition. In fact, the cases the government
25 cites require that there be some sort of clear connection

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1 between the two, or at least some logical connection so some
2 issue that the jury is trying to decide in the present case is
3 illustrated or helped by the prior tax evasion. And we see
4 nothing other than an appeal to you can believe that
5 Mr. Greenberg willfully engaged in this conduct because he has
6 a pattern of being a tax scofflaw. That seems to be the
7 argument, and that just seems to be propensity evidence and
8 doesn't seem to be supported by the cases.

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9 THE COURT: Thank you.
10 Mr. Wing.
11 MR. WING: Judge, I represent Larry Delap.
12 Mr. Delap is opposing an introduction of all of the
13 404(b) evidence against everybody, for a couple of reasons.
14 The first one is that none of the conduct that's alleged in any
15 of these 404(b) applications is conduct that he was involved in
16 or even knew about. I think the same is true of nine of the
17 other codefendants in this case. And the fact of the matter is
18 that even though the government is arguing here today as
19 404(b), they're also saying that most of this is part of
20 evidence, part of the general conspiracy, part of res gestae,
21 part of background, so there may be a fight at trial as to
22 whether we get a limiting instruction. But a limiting
23 instruction is simply not going to do it.
24 In the reply brief, the government cited Wright & K.
25 Graham Federal Practice and Procedure, citing Oshatz for the
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1 proposition, and I quote, "that three prior tax scams are
2 enough to show the unlikelihood that the defendant had entered
3 into the charged one innocently."
4 Well, we have more than three here. We have four that
5 are charged in the indictment. Actually, I think we have more
6 than four because my understanding is SOS is not just one, it's
7 many. And the big problem that every single defense lawyer has
8 in this case, whether they're charged with 404(b) or not, is
9 that in this six-, to eight-month trial, how is a jury going to
10 be able to somehow comprehend, retain, understand, and have in
11 their heads at the time they deliberate the evidence about each
12 one of these 18 individuals? It's a monumental task for the
13 lawyers who have been spending years on this case to understand
14 these facts.
15 The Court, I think, in the colloquy with Mr. Okula,
16 made it clear to everybody that these are complicated
17 transactions and that it isn't easy to understand, and to add
18 in one more thing simply exacerbates what's already an
19 extraordinary problem for every defendant in this case, if they
20 expect to get a fair verdict from a competent jury. And we
21 want the jurors to be able to understand the facts here.
22 I wasn't in the case in the beginning. It's my
23 understanding that when the first indictment came down, your
24 Honor advised the government that if they were going to
25 supersede, they should do it by a certain date and that would
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1 be it. I see all this 404(b) stuff as getting around that
2 request of the Court, if not order of the Court. It's all
3 these other crimes, many crimes, many people charged, and the
4 prejudice is substantial to everybody. It's particularly
5 substantial to the people who had nothing to do with this, and
6 there are many defendants in this case in that particular
7 position.
8 So what I would ask the Court to take what I think is
9 a fair and absolutely simple route here and deny the
10 government's motion across the board. Thanks.
11 THE COURT: Thank you.
12 MR. SCHEPER: David Scheper for Robert Pfaff.
13 Your Honor, very briefly, when we next write, the

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14 government's going to write something in a couple of weeks and
15 then we'll have a couple weeks thereafter. I guess what I
16 wanted to seek leave from the court, I heard Mr. Okula a few
17 moments ago seem to retreat from what he had said earlier about
18 Scandia and we're not going to involve the Scandia entity
19 because when he outlined what he anticipates --

20 THE COURT: He could prove the in limine motion
21 insofar as it related to the Scandia evidence.

22 MR. SCHEPER: I think from his utterances of a few
23 moments ago, what I'm left with is there's going to be a side
24 fee allegation from Somer Leasing, maybe from Sands, but then
25 he talked about numbers of other what he called fraudulent tax

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1 shelters that add up to a certain amount and that he says were
2 reported untimely and only as a reaction to an IRS
3 investigation.

4 I'll deal with what I think is an incorrect spin on
5 the facts about a reaction to an IRS investigation, but I do
6 appreciate Mr. Okula outlined it pretty clearly here, so I
7 don't think so I need him to write anything in a couple of
8 weeks. What troubles me though is I don't know what these
9 other transactions are about, and it's going to be very
10 difficult to address in the 404(b) setting what kinds of proofs
11 there are going to be about other unnamed or unmentioned
12 so-called fraudulent tax shelters. So I guess that would be
13 the one thing I'd ask the Court to direct Mr. Okula to write up
14 in two weeks. If we're not talking about Scandia, what are we
15 talking about, in addition to Sands and Somer Leasing, and to
16 put us on a little better notice as to what that fight is
17 about. And then we'll react to that two weeks hence.

18 THE COURT: Thank you.

19 MR. SCHEPER: Okay.

20 THE COURT: Anybody else?

21 MS. HOFFINGER: Hello again, for Mr. Ruble.
22 Judge, the government wants to put in some payments by
23 Chenary to Mr. Ruble in 1996 and 1997. According to them, they
24 are connected with Sands, so we would argue that those should
25 go out with Sands. But putting that aside, we're really asking

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1 the court to defer a ruling on the admissibility of any of the
2 1996 and 1997 payments until all of the evidence in this case
3 is in, consistent with what we believe is well-settled Second
4 Circuit law.

5 To be very clear, what we're saying is the following.
6 we have no intention of saying anything in our opening
7 statement to contest the elements of intent or knowledge with
8 respect to Mr. Ruble's personal tax counts. Also, we don't
9 intend to cross-examine any government witnesses to contest the
10 elements of intent or knowledge with respect to Mr. Ruble's tax
11 counts. Therefore, since it is not apparent that that's going
12 to be an issue, we ask that it be put off until the end of all
13 the evidence. We don't think the government will be prejudiced
14 by this, Judge. By their own admission, this is going to be
15 quite simple for them to put in, in terms of timing. I think
16 they have actually one additional witness, just to, I think, be
17 clear.

18 THE COURT: They'll be so exhausted by then, they

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19 won't even think about it.

20 MS. HOFFINGER: Okay.

21 THE COURT: If that happens.

22 MS. HOFFINGER: That's where we are. We believe that
23 the case law supports us on this. We've made a clear
24 statement, and we think it should await all the evidence.

25 THE COURT: Thank you.

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1 MR. GIOIELLA: Just briefly on Mr. Hastings.

2 As I understand it, the government has now conceded
3 that there was no tax evasion, so what they're saying is that
4 there was some kind of side payment that was included in a K1.
5 He accurately reported the K1 as the tax code and the
6 regulations require him to do. It had no effect on his taxes
7 whatsoever, and apparently the complaint is that he should have
8 taken the \$75,000 commission out of the K1 and put it on a
9 separate line item. If I understand it, that's all it's about.
10 And for the life of me, A, I don't think that's a bad act,
11 because the code requires you to report in accordance with your
12 K1, and, B, it certainly has nothing to do with this case.

13 THE COURT: Okay. Thank you.

14 MR. NIESPOLO: Your Honor, if I might, on a different
15 matter, I'm speaking to behalf of the defendants, and I've met
16 and conferred, as have others, with the government, and I would
17 ask if the court would allow me to speak to the possibility of
18 moving both the date due for witness and exhibit lists from the
19 defense in light of what the government is now making available
20 to us, and also possibly moving the trial date.

21 THE COURT: Not now.

22 MR. NIESPOLO: Your Honor, with regard to witnesses
23 and exhibits, it's due on Monday. And I would just put forth
24 to the court that, for me, and I think for most everybody here,
25 our case is in those documents. And for me and for others, the

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1 benefit that's being provided by this database is something
2 that we haven't had in terms of being able to search and find
3 these documents.

4 THE COURT: I understand all that. But I'm simply not
5 at this point prepared to do that. If you file your lists on
6 Monday and later on it turns out that you come up with
7 something else in a timely way, and you have a good explanation
8 for why you haven't come up with it before and there isn't any
9 significant prejudice to the government, I think you'd have a
10 reasonable expectation you'd be allowed to supplement. But I'm
11 not moving it now.

12 MR. NIESPOLO: Okay. I would just, in closing, your
13 Honor --

14 THE COURT: Believe me, I wake up every morning
15 wondering about the trial date.

16 MR. NIESPOLO: I would just observe to the court that
17 for a number of us, we are going to have access to databases
18 that we have not had access to.

19 THE COURT: I understand.

20 MR. NIESPOLO: Okay.

21 THE COURT: Thank you.

22 MR. DeVITA: Your Honor, I made an application which I
23 believe is unopposed with respect to an order allowing

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24 Ms. warley to disclose information relating to clients. I can
25 provide a witness list.
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1 THE COURT: Is that unopposed, Mr. Hillebrecht?
2 MR. HILLEBRECHT: Yes, your Honor. I think we put in
3 a brief letter.
4 THE COURT: I'm going to grant it.
5 MR. DeVITA: Thank you, your Honor.
6 THE COURT: I was just allowing the time to run.
7 Anything else?
8 MR. OKULA: May I just make one or two very quick
9 points from here, your Honor.
10 with respect to Mr. Pitofsky's argument that there is
11 insufficient similarity between his acts and the underlying
12 charges, I think the Bach case speaks plainly to that. In that
13 case, the personal evasion and false returns were charged, the
14 Court upheld the admission of failures to file from previous
15 years, and I think the language that's important from Bach is
16 that the prior failures to file spoke of an intent to evade the
17 tax system. And I think that that's a leading case, or one of
18 the leading cases in the circuit on that issue.
19 Finally, with respect to Mr. Ruble, saying that you're
20 not going to cross-examine, or you're not going to open on it
21 is not unequivocally taking knowledge and intent out of the
22 case sufficiently as called for by the case law. I think that
23 they have to demonstrate unequivocally, because we have to
24 prove knowledge and intent, and because this other proof really
25 speaks to what his knowledge and intent was, that they have to
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1 make clear one way or the other.
2 THE COURT: If the evidence was delayed to rebuttal,
3 and they hadn't opened the door to it by then, and you've got a
4 clear ruling prohibiting them from summing up on willfulness
5 then you would be fully protected. Right?
6 MR. OKULA: I agree with that, your Honor.
7 THE COURT: All right. Anyone else?
8 MR. HILLEBRECHT: Yes, your Honor. A scheduling
9 issue. The government's in limine motions are due on June 12.
10 And in our motions, we had anticipated making certain arguments
11 about the admissibility of certain categories of documents
12 pursuant to the coconspirator exception, business records
13 exception, and various others. In the defendants' motions in
14 limine, they have lodged objections to certain subsets of types
15 of documents admissible in the government's view pursuant to
16 those same rules.
17 As opposed to briefing it in two separate briefs and
18 having your Honor look at our position on the hearsay rules two
19 different times, what we would request permission to do is
20 address all our hearsay positions as well as the objections
21 raised to the certain subsets of those types of documents in
22 the June 12 submission, so we only submit one brief on the
23 hearsay issues.
24 THE COURT: In effect, you're delaying your
25 submission?
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1 MR. HILLEBRECHT: You could look at it that way.

2 THE COURT: Mr. Hillebrecht, no. I'll address them
3 now, sooner. What you're really doing here, not that you set
4 out to do it, is you basically appropriated to yourself my
5 vacation time to be devoted to dealing with your late arguments
6 on this, and we're not going there.

7 MR. HILLEBRECHT: Then, your Honor, yes, we will
8 address. My point is simply --

9 THE COURT: I agree with you, it should be addressed
10 once. Sooner, not later.

11 MR. HILLEBRECHT: Your Honor, I don't think that's
12 fair, given the scheduling previously set.

13 THE COURT: Look, they've moved against some of your
14 stuff in their in limine motions so you have to respond it.

15 MR. HILLEBRECHT: Very well.

16 THE COURT: On this further briefing on the 404(b), in
17 terms of memoranda, 35 pages on each side, no more, and unless
18 you've got a Second Circuit case squarely on point on a precise
19 factual issue, I basically don't want to hear the rhetoric
20 about 404(b) all over again. I've got it. What I want to
21 understand is the facts and the tax law to the extent it is
22 relevant to these transactions that we're talking about.

23 Thank you very much.
24 (Adjourned)

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EXHIBIT B

**IN THE SUPERIOR COURT
FOR THE
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS**

UNITED MICRONESIA DEVELOPMENT
ASSOCIATION, INC., and UMDA LAOLAO LLC,
Plaintiff(s),

CIVIL ACTION NO. 07-0152

-against-

AFFIDAVIT OF SERVICE

ROBERT PFAFF, et al.,
Defendant(s).

STATE OF NEW YORK)
S.S.
COUNTY OF NEW YORK)

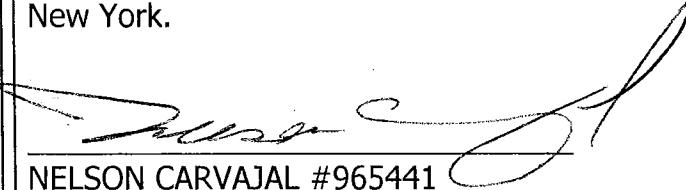
NELSON CARVAJAL, being duly sworn, deposes and says that he is over the age of eighteen years, is employed by the attorney service, DLS, INC., and is not a party to this action.

That on the 7th day of July 2008, at approximately the time of 8:20 p.m., deponent served a true copy of the **SUBPOENA DUCES TECUM AND SUBPOENA TO TESTIFY AT DEPOSITION** upon Dominick M. Degeorgio at 9 Jennings Meadow Road, Cold Spring Harbor, NY 11724, by personally delivering and leaving the same with his wife, Terry Degeorgio, a person of suitable age and discretion at that address, the actual place of residence. At the time of service, a witness fee in the sum of \$25.00 was tendered.

Terry Degeorgio is a white female, approximately 43 years of age, stands approximately 5 feet 6 inches tall and weighs approximately 140 pounds with blonde hair and brown eyes. She has freckles.

That on the 8th day of July 2008, deponent served another copy of the foregoing upon Dominick M. Degeorgio at 9 Jennings Meadow Road, Cold Spring Harbor, NY 11724, by first class mail, by enclosing a true copy thereof in a securely sealed and postpaid wrapper with the words "PERSONAL AND CONFIDENTIAL" written on the same envelope, and not indicating on the outside that it is from an attorney or

concerns an action against the person to be served, and depositing the same into an official depository maintained by the Government of the United States, City and State of New York.


NELSON CARVAJAL #965441

Sworn to before me this
8th day of July 2008


NOTARY PUBLIC

JONATHAN T. RIPPS
NOTARY PUBLIC - STATE OF NEW YORK
NO. 01RI6109718
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MAY 17, 2012

EXHIBIT C

6-12-03 irs pfaff

Interview ROBERT PFAFF - VOLUME I 6/12/2003

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1 INTERVIEW OF ROBERT PFAFF

2 VOLUME I

3 June 12, 2003

4

5

The within proceedings were held at 1244 Speer
6 Boulevard, Suite 500, Denver, Colorado, at 8:40 a.m.,
before Debbie Zoetewey, Registered Merit Reporter and
7 Notary Public within Colorado.

8

9 APPEARANCES

10 For the Government: ROBERT E. CUDLIP, ESQ.

Department of the Treasury

11 Internal Revenue Service

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Internal Revenue Agent

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18 Internal Revenue Agent

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19 450 Golden Gate Avenue SF6107

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20

For Mr. Pfaff: McGEE GRIGSBY, ESQ.

21 Latham & Watkins, LLP

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Interview ROBERT PFAFF - VOLUME I 6/12/2003

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1 PROCEEDINGS

2 * * * * *

3 MR. TERPACK: For the record, today is June 12,
4 2003. It's approximately 8:40 a.m. We're at the office
5 of chief counsel, 1244 Speer Boulevard, Denver, Colorado.

6 We are here to interview Mr. Robert Pfaff

7 regarding his personal federal income tax returns for
8 1998, 1999, 2000 and 2001; the federal income tax returns
9 of RP Investment Trust for 1998, 1999, 2000 and 2001; and
10 the federal income tax returns of RP Capital Trust from
11 1999, 2000, and 2001.

12 Before we go any further, for the record, why
13 don't we go around and introduce ourselves, and I will
14 also show my credentials at this time. My name is George
15 Terpack and I am an Internal Revenue agent. Here are my
16 credentials. Victoria.

17 MS. REX: I am Victoria Rex, and I'm a revenue

18 agent.

19 MR. CUDLIP: I'm Robert Cudlip, and I'm with the

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20 IRS counsel office.

21 MR. GRIGSBY: I'm McGee Grigsby from Latham &
22 Watkins, here representing Mr. Pfaff.

23 THE WITNESS: And I am Robert Pfaff.

24

25

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Interview ROBERT PFAFF - VOLUME I 6/12/2003

Page 3

1 ROBERT PFAFF,
2 being called as a witness by the Internal Revenue Service,
3 testified as follows:

4 EXAMINATION

5 BY MR. TERPACK:

6 Q. Mr. Pfaff, I've prepared a list that will list
7 the different entities and where you'd find them, and here
8 are the tax returns that you need to look at.

9 A. Okay.

10 Q. So why don't we get started. Basically, the
11 first question I like to ask is: Do you have any
12 questions about the examination process or the Privacy Act
13 notification?

14 A. I do not.

15 Q. Briefly, the taxpayer's appeal rights, you don't
16 have to agree with any findings I may come up with during
17 the examination. You have your full administrative appeal
18 rights and also your legal appeal rights, and I wanted to
19 make you aware of those. I think I've sent you Pub 1 at
20 least one time, probably many more. So if there's any
21 questions at this time, we would take them.

22 What is your current address?

23 A. Actually, I did have a question.

24 Q. Okay. Go ahead.

25 A. Mr. Grigsby told me that our 2001 return was
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Interview ROBERT PFAFF - VOLUME I 6/12/2003

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1 under exam, but I don't believe we got the actual notice.

2 I prepared for it and for - -

3 Q. You didn't get it?

4 A. I don't think so. I couldn't -- but that's
5 okay.

6 Q. You will have it immediately. You should have
7 it, and I think Mr. Grigsby got it. Right?

8 MR. GRIGSBY: I did receive it. I received a
9 letter that said -- actually, yeah, I have got a copy.

10 THE WITNESS: Okay.

11 MR. TERPACK: And I thought I'd given it to you
12 first because I didn't have a power of attorney, and then
13 later the power of attorney came.

14 THE WITNESS: I'm not objecting, just found out.

15 MR. TERPACK: No problem. I will make sure you
16 have a copy of it, those.

17 Q. (BY MR. TERPACK) What is your current address?

18 A. It's 93 Glenmore Drive, Englewood, Colorado,
19 80110, ZIP code. That ZIP code is changing and I think
20 it's 80113. I'll have to get back.

21 Q. And what is the current address for

22 RP Investment Trust?

23 A. That would be my office, 1735 19th Street,
24 Denver, Colorado, ZIP code 80202.

25 Q. What is the current address for RP Capital

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4 Interview ROBERT PFAFF - VOLUME II 6/13/2003

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1 INTERVIEW OF ROBERT PFAFF

2 VOLUME II

3 June 13, 2003

4

5

The within proceedings were continued at
6 1244 Speer Boulevard, Suite 500, Denver, Colorado, at
8:21 a.m., before Debbie Zoetewey, Registered Merit
7 Reporter and Notary Public within Colorado.

8

9 APPEARANCES

10 For the Government: ROBERT E. CUDLIP, ESQ.

Department of the Treasury

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Office of Chief Counsel

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Interview ROBERT PFAFF - VOLUME II 6/13/2003

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1 PROCEEDINGS

2 * * * * *

3 MS. REX: Today is June 13, 2003. And we are at
4 the office of chief counsel, 1244 Speer Boulevard in
5 Denver, Colorado. We are continuing the interview of
6 Robert Pfaff which we began on June 12 in the matter of
7 his personal federal income tax examination for the years
8 1998 through 2001.

9 Present, my name is Victoria Rex. I'm a revenue
10 agent with the Internal Revenue Service. And also with us
11 today is -- do you want to introduce yourself.

12 MR. TERPACK: My name is George Terpack. I'm a
13 revenue agent with the Internal Revenue Service.

14 MR. CUDLIP: Robert Cudlip from IRS counsel.

15 MR. GRIGSBY: McGee Grigsby from Latham &

16 Watkins. I represent Mr. Pfaff.

17 THE WITNESS: And I'm Mr. Pfaff.

18 EXAMINATION

19 BY MS. REX:

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EXHIBIT C PAGE 49